New Mountain Finance Corp
Form 497
October 24, 2016

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This preliminary prospectus supplement relates to an effective registration statement under the Securities Act of 1933, as amended, but the information in this preliminary prospectus supplement is not complete and may be changed. This preliminary prospectus supplement and the accompanying prospectus are not an offer to sell and are not soliciting an offer to buy these securities in any jurisdiction where the offer and sale is not permitted.

Subject to Completion, Dated October 24, 2016

PRELIMINARY PROSPECTUS SUPPLEMENT
(to Prospectus dated October 7, 2016)

5,000,000 Shares

New Mountain Finance Corporation

Common Stock

We are a Delaware corporation that was originally incorporated on June 29, 2010. We are a closed-end, non-diversified management investment company that has elected to be regulated as a business development company under the Investment Company Act of 1940, as amended. Our investment objective is to generate current income and capital appreciation through the sourcing and origination of debt securities at all levels of the capital structure, including first and second lien debt, notes, bonds and mezzanine securities. In some cases, our investments may also include equity interests. Our primary focus is in the debt of defensive growth companies, which are defined as generally exhibiting the following characteristics: (i) sustainable secular growth drivers, (ii) high barriers to competitive entry, (iii) high free cash flow after capital expenditure and working capital needs, (iv) high returns on assets and (v) niche market dominance.

The investments that we invest in are almost entirely rated below investment grade or may be unrated, which are often referred to as "leveraged loans", "high yield" or "junk" debt investments, and may be considered "high risk" or speculative compared to debt investments that are rated investment grade. Such issuers are considered more likely than investment grade issuers to default on their payments of interest and principal and such risk of default could reduce our net asset value and income distributions. Our investments are also primarily floating rate debt investments that contain interest reset provisions that may make it more difficult for borrowers to make debt repayments to us if interest rates rise. In addition, some of our debt investments will not fully amortize during their lifetime, which could result in a loss or a substantial amount of unpaid principal and interest due upon maturity. Our debt investments may also lose significant market value before a default occurs. Furthermore, an active trading market may not exist for these securities. This illiquidity may make it more difficult to value our investments.

We are offering for sale 5,000,000 shares of our common stock. We have granted the underwriters a 30-day option to purchase up to 750,000 additional shares of our common stock at the public offering price, less underwriting discounts and commissions.

Our common stock is listed on the New York Stock Exchange under the symbol "NMFC". On October 21, 2016, the last reported sales price on the New York Stock Exchange for our common stock was $13.68 per share, and the net asset value per share of our common stock on June 30, 2016 (the last date prior to the date of this prospectus supplement on which we determined our net asset value per share) was $13.23.

An investment in our common stock is very risky and highly speculative. Shares of closed-end investment companies, including business development companies, frequently trade at a discount to their net asset value. In addition, the companies in which we invest in are subject to special risks. See "Risk Factors" beginning on page 30 of the accompanying prospectus to read about factors you should consider, including the risk of leverage, before investing in our common stock.

This prospectus supplement and the accompanying prospectus contain important information about us that a prospective investor should know before investing in our common stock. Please read this prospectus supplement and the accompanying prospectus before investing and keep it for future reference. We file annual, quarterly and current reports, proxy statements and other information with the United States Securities and Exchange Commission (http://www.sec.gov), which is available free of charge by contacting us by mail at 787 Seventh Avenue, 48th Floor, New York, New York 10019 or on our website at http://www.newmountainfinance.com. Information contained on our website is not incorporated by reference into this prospectus supplement and the accompanying prospectus, and you should not consider that information to be part of this prospectus supplement and the accompanying prospectus.

Neither the United States Securities and Exchange Commission nor any state securities commission has approved or disapproved of these securities, or determined if this prospectus supplement or the accompanying prospectus is truthful or complete. Any representation to the contrary is a criminal offense.

	Per Share	**Total(3)**
Public Offering Price	$	$
Sales Load paid by us (Underwriting Discounts and Commissions)(1)	$	$
Proceeds to us (before expenses)(2)	$	$
Sales Loan payable to the underwriters by Investment Adviser (Underwriting Discounts and Commissions)(1)(2)	$	$

(1) See "Underwriting" for details of compensation to be received by the underwriters.

(2) New Mountain Finance Advisers BDC, L.L.C. (the "Investment Adviser") has agreed to bear $, or $ per share, of the sales load in connection with this offering, which is reflected in the above table. All payments made by the Investment Adviser will not be subject to reimbursement by us. All other expenses of the offering will be borne by us. We will incur approximately $0.4 million of estimated expenses in

connection with this offering.

(3) To the extent that the underwriters sell more than 5,000,000 shares of our common stock, the underwriters have the option to purchase up to an additional 750,000 shares of our common stock at the public offering price, less the sales load, within 30 days of the date of this prospectus supplement. If the underwriters exercise this option in full, the total public offering price, sales load payable by us, proceeds to us and sales load payable by the Investment Adviser will be $, $, $ and $, respectively. See "Underwriting".

The underwriters expect to deliver the shares against payment in New York, New York on or about , 2016.

Joint-Lead Bookrunners

Wells Fargo Securities **Goldman, Sachs & Co.** **Morgan Stanley** **Keefe, Bruyette & Woods**
A Stifel Company

Lead Manager

Baird

Co-Managers

Janney Montgomery Scott **Oppenheimer & Co.**

Prospectus Supplement dated , 2016

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PROSPECTUS SUPPLEMENT

PROSPECTUS

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ABOUT THIS PROSPECTUS SUPPLEMENT

You should rely only on the information contained in this prospectus supplement and the accompanying prospectus. Neither we nor the underwriters have authorized any other person to provide you with different information from that contained in this prospectus supplement or the accompanying prospectus. If anyone provides you with different or inconsistent information, you should not rely on it. This prospectus supplement and the accompanying prospectus do not constitute an offer to sell, or a solicitation of an offer to buy, any shares of our common stock by any person in any jurisdiction where it is unlawful for that person to make such an offer or solicitation or to any person in any jurisdiction to whom it is unlawful to make such an offer or solicitation. The information contained in this prospectus supplement and the accompanying prospectus is complete and accurate only as of their respective dates, regardless of the time of their delivery or sale of our common stock. This prospectus supplement supersedes the accompanying prospectus to the extent it contains information different from or additional to the information in that prospectus.

This document is in two parts. The first part is this prospectus supplement, which describes the terms of this offering of common stock and also adds to and updates information contained in the accompanying prospectus. The second part is the accompanying prospectus, which gives more general information and disclosure. To the extent the information contained in this prospectus supplement differs from the information contained in the accompanying prospectus, the information in this prospectus supplement shall control. Please carefully read this prospectus supplement and the accompanying prospectus together with any exhibits and the additional information described under "Available Information" and in the "Prospectus Supplement Summary", "Prospectus Summary" and "Risk Factors" sections of this prospectus supplement and the accompanying prospectus before you make an investment decision. Unless otherwise indicated, all information included in this prospectus supplement assumes no exercise by the underwriters of their option to purchase up to an additional 5,000,000 shares of our common stock.

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PROSPECTUS SUPPLEMENT SUMMARY

This summary highlights some of the information in this prospectus supplement and the accompanying prospectus. It may not contain all the information that is important to you. For a more complete understanding, we encourage you to read this entire prospectus supplement and the accompanying prospectus and the documents to which we have referred in this prospectus supplement, together with the accompanying prospectus, including the risks set forth under "Risk Factors" and the other information included in this prospectus supplement and the accompanying prospectus.

In this prospectus supplement, unless the context otherwise requires, references to:

"NMFC", the "Company", "we", "us" and "our" refers to New Mountain Finance Corporation, a Delaware corporation, which was incorporated on June 29, 2010, including, where appropriate, its wholly-owned direct and indirect subsidiaries;

"NMF Holdings" and "Predecessor Operating Company" refers to New Mountain Finance Holdings, L.L.C., a Delaware limited liability company. References to NMF Holdings include its wholly-owned subsidiary, NMF SLF, unless the context otherwise requires. References to NMF Holdings exclude NMF SLF when referencing NMF Holdings' common membership units, board of directors, and credit facility or leverage;

"NMF SLF" refers to New Mountain Finance SPV Funding, L.L.C., a Delaware limited liability company;

"SBIC GP" refers to New Mountain Finance SBIC G.P. L.L.C., a Delaware limited liability company;

"SBIC LP" refers to New Mountain Finance SBIC L.P., a Delaware limited partnership;

"Guardian AIV" refers to New Mountain Guardian AIV, L.P.;

"AIV Holdings" refers to New Mountain Finance AIV Holdings Corporation, a Delaware corporation which was incorporated on March 11, 2011, of which Guardian AIV was the sole stockholder;

"Investment Adviser" refers to New Mountain Finance Advisers BDC, L.L.C., our investment adviser;

"Administrator" refers to New Mountain Finance Administration, L.L.C., our administrator;

"New Mountain Capital" refers to New Mountain Capital Group, L.L.C. and its affiliates;

"Predecessor Entities" refers to New Mountain Guardian (Leveraged), L.L.C. and New Mountain Guardian Partners, L.P., together with their respective direct and indirect wholly-owned subsidiaries prior to our initial public offering;

"NMFC Credit Facility" refers to our Senior Secured Revolving Credit Agreement with Goldman Sachs Bank USA, Morgan Stanley Bank, N.A. and Stifel Bank & Trust, dated June 4, 2014, as amended (together with the related guarantee and security agreement);

"Holdings Credit Facility" refers to NMF Holdings' Second Amended and Restated Loan and Security Agreement with Wells Fargo Bank, National Association, dated December 18, 2014;

"Predecessor Holdings Credit Facility" refers to NMF Holdings' Amended and Restated Loan and Security Agreement with Wells Fargo Bank, National Association, dated May 19, 2011, as amended;

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"SLF Credit Facility" refers to NMF SLF's Loan and Security Agreement with Wells Fargo Bank, National Association, dated October 27, 2010, as amended;

"Convertible Notes" refers to our 5.00% convertible notes due 2019 issued on June 3, 2014 and September 30, 2016 under an indenture dated June 3, 2014 (the "Indenture"), between us and U.S. Bank National Association, as trustee; and

"Unsecured Notes" refers to our 5.313% unsecured notes due May 15, 2021 issued on May 6, 2016 under a note purchase agreement, dated May 4, 2016, to an institutional investor in a private placement together with our 5.313% unsecured notes due May 15, 2021 issued on September 30, 2016 under an amended and restated note purchase agreement, dated September 30, 2016, to institutional investors in a private placement.

For the periods prior to and as of December 31, 2013, all financial information provided in this prospectus supplement and accompanying prospectus reflect our organizational structure prior to the restructuring on May 8, 2014 described under "Description of Restructuring" in the accompanying prospectus, where NMF Holdings functioned as the operating company.

Overview

New Mountain Finance Corporation

We are a Delaware corporation that was originally incorporated on June 29, 2010. We are a closed-end, non-diversified management investment company that has elected to be regulated as a business development company ("BDC") under the Investment Company Act of 1940, as amended (the "1940 Act"). As such, we are obligated to comply with certain regulatory requirements. We have elected to be treated, and intend to comply with the requirements to continue to qualify annually, as a regulated investment company ("RIC") under Subchapter M of the Internal Revenue Code of 1986, as amended, (the "Code"). We are also registered as an investment adviser under the Investment Advisers Act of 1940, as amended.

On May 19, 2011, we priced our initial public offering (the "IPO") of 7,272,727 shares of common stock at a public offering price of $13.75 per share. Concurrently with the closing of the IPO and at the public offering price of $13.75 per share, we sold an additional 2,172,000 shares of our common stock to certain executives and employees of, and other individuals affiliated with, New Mountain Capital in a concurrent private placement (the "Concurrent Private Placement"). Additionally, 1,252,964 shares were issued to the partners of New Mountain Guardian Partners, L.P. at that time for their ownership interest in the Predecessor Entities. In connection with our IPO and through a series of transactions, NMF Holdings acquired all of the operations of the Predecessor Entities, including all of the assets and liabilities related to such operations.

New Mountain Finance Holdings, L.L.C.

NMF Holdings is a Delaware limited liability company. Until May 8, 2014, NMF Holdings was externally managed and was regulated as a BDC under the 1940 Act. As such, NMF Holdings was obligated to comply with certain regulatory requirements. NMF Holdings was treated as a partnership for United States ("U.S.") federal income tax purposes for so long as it had at least two members. With the completion of the underwritten secondary offering on February 3, 2014, NMF Holdings' existence as a partnership for U.S. federal income tax purposes terminated and NMF Holdings became an entity that is disregarded as a separate entity from its owner for U.S. federal tax purposes. See "Material Federal Income Tax Considerations" in the accompanying prospectus. For additional information on our organizational structure prior to May 8, 2014, see "Description of Restructuring" in the accompanying prospectus.

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Until May 8, 2014, NMF Holdings was externally managed by the Investment Adviser. As of May 8, 2014, the Investment Adviser serves as our external investment adviser. The Administrator provides the administrative services necessary for operations. The Investment Adviser and Administrator are wholly-owned subsidiaries of New Mountain Capital. New Mountain Capital is a firm with a track record of investing in the middle market and with assets under management totaling more than $15.0 billion(1), which includes total assets held by us. New Mountain Capital focuses on investing in defensive growth companies across its private equity, public equity, and credit investment vehicles. NMF Holdings, formerly known as New Mountain Guardian (Leveraged), L.L.C., was originally formed as a subsidiary of Guardian AIV by New Mountain Capital in October 2008. Guardian AIV was formed through an allocation of approximately $300.0 million of the $5.1 billion of commitments supporting New Mountain Partners III, L.P., a private equity fund managed by New Mountain Capital. In February 2009, New Mountain Capital formed a co-investment vehicle, New Mountain Guardian Partners, L.P., comprising $20.4 million of commitments.

Prior to December 18, 2014, NMF SLF was a Delaware limited liability company. NMF SLF was a wholly-owned subsidiary of NMF Holdings and thus a wholly-owned indirect subsidiary of us. NMF SLF was bankruptcy-remote and non-recourse to us. As part of an amendment to our existing credit facilities with Wells Fargo Bank, National Association, NMF SLF merged with and into NMF Holdings on December 18, 2014. See "Management's Discussion and Analysis of Financial Conditions and Results of Operations Liquidity and Capital Resources Borrowings" in the accompanying prospectus for additional information on our borrowings.

Current Organization

Our wholly-owned subsidiaries, NMF Ancora Holdings Inc., NMF QID NGL Holdings, Inc. and NMF YP Holdings Inc., are structured as Delaware entities that serve as tax blocker corporations which hold equity or equity-like investments in portfolio companies organized as limited liability companies (or other forms of pass-through entities). We consolidate our tax blocker corporations for accounting purposes. The tax blocker corporations are not consolidated for income tax purposes and may incur income tax expense as a result of their ownership of the portfolio companies. Additionally, our wholly-owned subsidiary, New Mountain Finance Servicing, L.L.C. serves as the administrative agent on certain investment transactions. SBIC LP, and its general partner, SBIC GP, were organized in Delaware as a limited partnership and limited liability company, respectively. SBIC LP and SBIC GP are our consolidated wholly-owned direct and indirect subsidiaries. SBIC LP received a license from the U.S. Small Business Administration (the "SBA") to operate as a small business investment company under Section 301(c) of the Small Business Investment Act of 1958, as amended.

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(1) Includes amounts committed, not all of which have been drawn down and invested to-date, as of June 30, 2016, as well as amounts called and returned since inception.

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The diagram below depicts our organizational structure as of October 21, 2016.

* Includes partners of New Mountain Guardian Partners, L.P.

** NMFC is the sole limited partner of SBIC LP. NMFC, directly or indirectly through SBIC GP, wholly-owns SBIC LP. NMFC owns 100.0% of SBIC GP which owns 1.0% of SBIC LP. NMFC owns 99.0% of SBIC LP.

Our investment objective is to generate current income and capital appreciation through the sourcing and origination of debt securities at all levels of the capital structure, including first and second lien debt, notes, bonds and mezzanine securities. In some cases, our investments may also include equity interests. The primary focus is in the debt of defensive growth companies, which are defined as generally exhibiting the following characteristics: (i) sustainable secular growth drivers, (ii) high barriers to competitive entry, (iii) high free cash flow after capital expenditure and working capital needs, (iv) high returns on assets and (v) niche market dominance. Similar to us, SBIC LP's investment objective is to generate current income and capital appreciation under our investment criteria. However, SBIC LP's investments must be in SBA eligible companies. Our portfolio may be concentrated in a limited number of industries. As of June 30, 2016, our top five industry concentrations were business services, software, education, federal services and distribution & logistics.

The investments that we invest in are almost entirely rated below investment grade or may be unrated, which are often referred to as "leveraged loans", "high yield" or "junk" debt investments, and may be considered "high risk" or speculative compared to debt investments that are rated investment grade. Such issuers are considered more likely than investment grade issuers to default on their payments of interest and principal and such risk of default could reduce our net asset value and income distributions. Our investments are also primarily floating rate debt investments that contain interest reset provisions that may make it more difficult for borrowers to make debt repayments to us if interest rates rise. In addition, some of our debt investments will not fully amortize during their lifetime, which could result in a loss or a substantial amount of unpaid principal and interest due upon maturity. Our debt investments may also lose significant market value before a default occurs. Furthermore, an active trading market may not exist for these securities. This illiquidity may make it more difficult to value our investments.

As of June 30, 2016, our net asset value was $843.3 million and our portfolio had a fair value of approximately $1,498.1 million in 72 portfolio companies, with a weighted average yield to maturity at cost ("Yield to Maturity at Cost") of approximately 10.3%. This Yield to Maturity at Cost

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calculation assumes that all investments, including secured collateralized agreements, not on non-accrual are purchased at the adjusted cost on the quarter end date and held until their respective maturities with no prepayments or losses and exited at par at maturity. Adjusted cost reflects the accounting principles generally accepted in the United States of America ("GAAP") cost for post-IPO investments and a stepped up cost basis of pre-IPO investments (assuming a step-up to fair market value occurred on the IPO date). This calculation excludes the impact of existing leverage. Yield to Maturity at Cost uses the London Interbank Offered Rate ("LIBOR") curves at each quarter's end date. The actual yield to maturity may be higher or lower due to the future selection of the LIBOR contracts by the individual companies in our portfolio or other factors.

Recent Developments

Appointment of President

John R. Kline was promoted to be our President on July 19, 2016 in addition to maintaining his role as our Chief Operating Officer. Robert A. Hamwee, who previously held the title of President and Chief Executive Officer ("CEO"), will continue in his capacity as our CEO.

Distribution

On August 2, 2016, our board of directors declared a third quarter 2016 distribution of $0.34 per share, which was paid on September 30, 2016 to holders of record as of September 16, 2016.

New Mountain Net Lease Corporation

New Mountain Net Lease Corporation ("NMNLC") was formed as a Maryland corporation on April 18, 2016 and commenced operations on August 12, 2016. NMNLC was formed to acquire commercial real properties that are subject to "triple net" leases and to qualify as a real estate investment trust, or REIT, within the meaning of Section 856(a) of the Code. We have determined that NMNLC is not an investment company under Accounting Standards Codification Topic 946, *Financial Services Investment Companies* and in accordance with such guidance we will generally not consolidate our investment in a company other than a wholly-owned investment company subsidiary. Accordingly, NMNLC is a wholly-owned non-consolidated portfolio company of NMFC.

Convertible Notes Offering

On September 30, 2016, we closed a public offering of an additional $40.25 million in aggregate principal amount (including $5.25 million in aggregate principal amount issued pursuant to the underwriters' overallotment option) of our Convertible Notes. These additional Convertible Notes constitute a further issuance of, rank equally in right of payment with, and form a single series with the $115.0 million in aggregate principal amount of Convertible Notes that we issued on June 3, 2014, pursuant to the Indenture. See "Management's Discussion and Analysis of Financial Conditions and Results of Operations Liquidity and Capital Resources Borrowings" in the accompanying prospectus for a discussion of the terms of the Convertible Notes.

Unsecured Notes

On September 30, 2016, we entered into an amended and restated note purchase agreement (the "Amended Note Purchase Agreement") related to our existing Unsecured Notes. The Amended Note Purchase Agreement amends and restates the Note Purchase Agreement dated May 4, 2016 (the "Existing NPA"), pursuant to which we issued $50.0 million in aggregate principal amount of the Unsecured Notes in May 2016. The Amended Note Purchase Agreement was entered into in

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connection with the issuance of an additional $40.0 million in aggregate principal amount of the Unsecured Notes to institutional investors in a private placement, which closed on September 30, 2016. The Amended Note Purchase Agreement also amended and restated the Existing NPA to provide for future issuances of Unsecured Notes in separate series or tranches under the Amended Note Purchase Agreement and supplements thereto. See "Management's Discussion and Analysis of Financial Conditions and Results of Operations Liquidity and Capital Resources Borrowings" in the accompanying prospectus for a discussion of the terms of the Unsecured Notes.

Preliminary Estimates of Net Asset Value and Net Investment Income

Set forth below is a preliminary estimate of our net asset value per share as of September 30, 2016 and a preliminary estimate of our net investment income per share range for the three months ended September 30, 2016. The following estimates are not a comprehensive statement of our financial condition or results for the period from December 31, 2015 through September 30, 2016. We advise you that our actual results for the three months ended September 30, 2016 may differ materially from these estimates, which are given only as of the date of this prospectus supplement, as a result of the completion of our financial closing procedures, final adjustments and other developments, including changes in interest rates, changes in the businesses to whom we have made loans or market and industry fluctuations, which may arise between now and the time that our financial results for the three months ended September 30, 2016 are finalized. This information is inherently uncertain.

As of the date of this prospectus supplement, we currently expect that our net investment income per share was between $0.34 and $0.35 for the three months ended September 30, 2016.

As of the date of this prospectus supplement, we estimate that our net asset value per share as of September 30, 2016 was approximately $13.25 to $13.30, which reflects an overall increase in market prices of our investments since June 30, 2016, but also includes a further mark down of the fair value of our investment in Transtar Holding Company from $11.4 million to approximately $3.8 million, due to its ongoing restructuring.

The preliminary financial estimates provided herein have been prepared by, and are the responsibility of, management. Neither Deloitte & Touche LLP, our independent registered public accounting firm, nor any other independent accountants, have audited, reviewed, compiled, or performed any procedures with respect to the accompanying preliminary financial data. Accordingly, Deloitte & Touche LLP does not express an opinion or any form of assurance with respect thereto and assumes no responsibility for, and disclaims any association with, this information.

The Investment Adviser

The Investment Adviser, a wholly-owned subsidiary of New Mountain Capital, manages our day-to-day operations and provides us with investment advisory and management services. In particular, the Investment Adviser is responsible for identifying attractive investment opportunities, conducting research and due diligence on prospective investments, structuring our investments and monitoring and servicing our investments. We currently do not have, and do not intend to have, any employees. As of June 30, 2016, the Investment Adviser was supported by approximately 100 staff members of New Mountain Capital, including approximately 60 investment professionals.

The Investment Adviser is managed by a five member investment committee (the "Investment Committee"), which is responsible for approving purchases and sales of our investments above $10.0 million in aggregate by issuer. The Investment Committee currently consists of Steven B. Klinsky, Robert A. Hamwee, Adam B. Weinstein and John R. Kline. The fifth and final member of the

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Investment Committee will consist of a New Mountain Capital Managing Director who will hold the position on the Investment Committee on an annual rotating basis. Beginning in August 2016, Mathew J. Lori was appointed to the Investment Committee for a one year term. In addition, our executive officers and certain investment professionals of the Investment Adviser are invited to all Investment Committee meetings. Purchases and dispositions below $10.0 million may be approved by our Chief Executive Officer. These approval thresholds are subject to change over time. We expect to benefit from the extensive and varied relevant experience of the investment professionals serving on the Investment Committee, which includes expertise in private equity, primary and secondary leveraged credit, private mezzanine finance and distressed debt.

Competitive Advantages

We believe that we have the following competitive advantages over other capital providers to middle market companies:

Proven and Differentiated Investment Style With Areas of Deep Industry Knowledge

In making its investment decisions, the Investment Adviser applies New Mountain Capital's long-standing, consistent investment approach that has been in place since its founding more than 15 years ago. We focus on companies in defensive growth niches of the middle market space where we believe few debt funds have built equivalent research and operational size and scale.

We benefit directly from New Mountain Capital's private equity investment strategy that seeks to identify attractive investment sectors from the top down and then works to become a well positioned investor in these sectors. New Mountain Capital focuses on companies and industries with sustainable strengths in all economic cycles, particularly ones that are defensive in nature, that have secular tailwinds and can maintain pricing power in the midst of a recessionary and/or inflationary environment. New Mountain Capital focuses on companies within sectors in which it has significant expertise (examples include software, education, niche healthcare, business services, federal services and distribution & logistics) while typically avoiding investments in companies with products or services that serve markets that are highly cyclical, have the potential for long-term decline, are overly-dependent on consumer demand or are commodity-like in nature.

In making its investment decisions, the Investment Adviser has adopted the approach of New Mountain Capital, which is based on three primary investment principles:

1. A generalist approach, combined with proactive pursuit of the highest quality opportunities within carefully selected industries, identified via an intensive and structured ongoing research process;

2. Emphasis on strong downside protection and strict risk controls; and

3. Continued search for superior risk adjusted returns, combined with timely, intelligent exits and outstanding return performance.

Experienced Management Team and Established Platform

The Investment Adviser's team members have extensive experience in the leveraged lending space. Steven B. Klinsky, New Mountain Capital's Founder, Chief Executive Officer and Managing Director and Chairman of our board of directors, was a general partner of Forstmann Little & Co., a manager of debt and equity funds totaling multiple billions of dollars in the 1980s and 1990s. He was also a co-founder of Goldman, Sachs & Co.'s Leverage Buyout Group in the period from 1981 to 1984. Robert A. Hamwee, our Chief Executive Officer and Managing Director of New Mountain Capital, was formerly President of GSC Group, Inc. ("GSC"), where he was the portfolio manager of GSC's distressed debt funds and led the development of GSC's CLOs. John R. Kline, our President

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and Chief Operating Officer and Managing Director of New Mountain Capital, worked at GSC as an investment analyst and trader for GSC's control distressed and corporate credit funds and at Goldman, Sachs & Co. in the Credit Risk Management and Advisory Group.

Many of the debt investments that we have made to date have been in the same companies with which New Mountain Capital has already conducted months of intensive acquisition due diligence related to potential private equity investments. We believe that private equity underwriting due diligence is usually more robust than typical due diligence for loan underwriting. In its underwriting of debt investments, the Investment Adviser is able to utilize the research and hands-on operating experience that New Mountain Capital's private equity underwriting teams possess regarding the individual companies and industries. Business and industry due diligence is led by a team of investment professionals of the Investment Adviser that generally consists of three to seven individuals, typically based on their relevant company and/or industry specific knowledge. Additionally, the Investment Adviser is also able to utilize its relationships with operating management teams and other private equity sponsors. We believe this differentiates us from many of our competitors.

Significant Sourcing Capabilities and Relationships

We believe the Investment Adviser's ability to source attractive investment opportunities is greatly aided by both New Mountain Capital's historical and current reviews of private equity opportunities in the business segments we target. To date, a significant majority of the investments that we have made are in the debt of companies and industry sectors that were first identified and reviewed in connection with New Mountain Capital's private equity efforts, and the majority of our current pipeline reflects this as well. Furthermore, the Investment Adviser's investment professionals have deep and longstanding relationships in both the private equity sponsor community and the lending/agency community which they have and will continue to utilize to generate investment opportunities.

Risk Management through Various Cycles

New Mountain Capital has emphasized tight control of risk since its inception and long before the recent global financial distress began. To date, New Mountain Capital has never experienced a bankruptcy of any of its portfolio companies in its private equity efforts. The Investment Adviser seeks to emphasize tight control of risk with our investments in several important ways, consistent with New Mountain Capital's historical approach. In particular, the Investment Adviser:

- Emphasizes the origination or purchase of debt in what the Investment Adviser believes are defensive growth companies, which are less likely to be dependent on macro-economic cycles;

- Targets investments in companies that are preeminent market leaders in their own industries, and when possible, investments in companies that have strong management teams whose skills are difficult for competitors to acquire or reproduce; and

- Targets investments in companies with significant equity value in excess of our debt investments.

Access to Non Mark to Market, Seasoned Leverage Facility

The amount available under the Holdings Credit Facility is generally not subject to reduction as a result of mark to market fluctuations in our portfolio investments. None of our credit facilities mature prior to June 2019. For a detailed discussion of our credit facilities, see "Management's

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Discussion and Analysis of Financial Conditions and Results of Operations   Liquidity and Capital Resources" in the accompanying prospectus.

Market Opportunity

We believe that the size of the market for investments that we target, coupled with the demands of middle market companies for flexible sources of capital at competitive terms and rates, create an attractive investment environment for us.

The leverage finance market has a high level of financing needs over the next several years due to significant bank debt maturities and significant amounts of private equity investable capital. We believe that the large dollar volume of loans that need to be refinanced will present attractive opportunities to invest capital in a manner consistent with our stated objectives.

Middle market companies continue to face difficulties in accessing the capital markets. We believe opportunities to serve the middle market will continue to exist. While many middle market companies were formerly able to raise funds by issuing high-yield bonds, we believe this approach to financing has become more difficult in recent years as institutional investors have sought to invest in larger, more liquid offerings.

Increased regulatory scrutiny of banks has reduced middle market lending. We believe that many traditional bank lenders to middle market businesses have either exited or de-emphasized their service and product offerings in the middle market. These traditional lenders have instead focused on lending and providing other services to large corporate clients. We believe this has resulted in fewer key players and the reduced availability of debt capital to the companies we target.

Attractive pricing. Reduced access to, and availability of, debt capital typically increases the interest rates, or pricing, of loans for middle market lenders. Recent primary debt transactions in this market often include upfront fees, original issue discount, prepayment protections and, in some cases, warrants to purchase common stock, all of which should enhance the profitability of new loans to lenders.

Conservative deal structures. As a result of the credit crisis, many lenders are requiring larger equity contributions from financial sponsors. Larger equity contributions create an enhanced margin of safety for lenders because leverage is a lower percentage of the implied enterprise value of the company.

Large pool of uninvested private equity capital available for new buyouts. We expect that private equity firms will continue to pursue acquisitions and will seek to leverage their equity investments with mezzanine loans and/or senior loans (including traditional first and second lien, as well as unitranche loans) provided by companies such as ours.

Operating and Regulatory Structure

We are a closed-end, non-diversified management investment company that has elected to be regulated as a BDC under the 1940 Act and are required to maintain an asset coverage ratio, as defined in the 1940 Act, of at least 200.0%. We include the assets and liabilities of our consolidated subsidiaries for purposes of satisfying the requirements under the 1940 Act. See "Regulation" in the accompanying prospectus.

We have elected to be treated, and intend to comply with the requirements to continue to qualify annually, as a RIC under Subchapter M of the Code. See "Material Federal Income Tax Considerations" in the accompanying prospectus. As a RIC, we generally will not be subject to

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corporate-level U.S. federal income taxes on any net ordinary income or capital gains that we timely distribute to our stockholders as dividends if it meets certain source-of-income, distribution and asset diversification requirements. We intend to distribute to our stockholders substantially all of our annual taxable income except that we may retain certain net capital gains for reinvestment.

Risks

An investment in our securities involves risk, including the risk of leverage and the risk that our operating policies and strategies may change without prior notice to our stockholders or prior stockholder approval. See "Risk Factors" and the other information included in the accompanying prospectus for a discussion of factors you should carefully consider before deciding to invest in our securities. The value of our assets, as well as the market price of our securities, will fluctuate. Our investments may be risky, and you may lose all or part of your investment. Investing in us involves other risks, including the following:

- We may suffer credit losses;
- We do not expect to replicate the Predecessor Entities' nor our historical performance or the historical performance of other entities managed or supported by New Mountain Capital;
- There is uncertainty as to the value of our portfolio investments because most of our investments are, and may continue to be in private companies and recorded at fair value;
- Our ability to achieve our investment objective depends on key investment personnel of the Investment Adviser. If the Investment Adviser were to lose any of its key investment personnel, our ability to achieve our investment objective could be significantly harmed;
- The Investment Adviser has limited experience managing a BDC or a RIC, which could adversely affect our business;
- We operate in a highly competitive market for investment opportunities and may not be able to compete effectively;
- Our investments in securities rated below investment grade are speculative in nature and are subject to additional risk factors such as increased possibility of default, illiquidity of the security, and changes in value based on changes in interest rates;
- Our business, results of operations and financial condition depends on our ability to manage future growth effectively;
- We borrow money, which could magnify the potential for gain or loss on amounts invested in us and increase the risk of investing in us;
- Changes in interest rates may affect our cost of capital and net investment income;
- Regulations governing the operations of BDCs will affect our ability to raise additional equity capital as well as our ability to issue senior securities or borrow for investment purposes, any or all of which could have a negative effect on our investment objectives and strategies;

We may experience fluctuations in our annual and quarterly results due to the nature of our business;

Our board of directors may change our investment objective, operating policies and strategies without prior notice or stockholder approval, the effects of which may be adverse to your interests;

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We will be subject to corporate-level U.S. federal income tax on all of our income if we are unable to maintain RIC status under Subchapter M of the Code, which would have a material adverse effect on our financial performance;

We may not be able to pay you distributions on our common stock, our distributions to you may not grow over time and a portion of our distributions to you may be a return of capital for U.S. federal income tax purposes;

Our investments in portfolio companies may be risky, and we could lose all or part of any of our investments;

The lack of liquidity in our investments may adversely affect our business;

Economic recessions, downturns or government spending cuts could impair our portfolio companies and harm our operating results;

The market price of our common stock may fluctuate significantly; and

Sales of substantial amounts of our common stock in the public market may have an adverse effect on the market price of our common stock.

Company Information

Our administrative and executive offices are located at 787 Seventh Avenue, 48th Floor, New York, New York 10019, and our telephone number is (212) 720-0300. We maintain a website at *http://www.newmountainfinance.com*. Information contained on our website is not incorporated by reference into this prospectus supplement or the accompanying prospectus, and you should not consider information contained on our website to be part of this prospectus supplement or the accompanying prospectus.

Presentation of Historical Financial Information and Market Data

Historical Financial Information

Unless otherwise indicated, historical references contained in the accompanying prospectus for periods prior to and as of December 31, 2013 in "Selected Financial and Other Data", "Selected Quarterly Data", "Management's Discussion and Analysis of Financial Condition and Results of Operations", "Senior Securities" and "Portfolio Companies" relate to NMF Holdings. The consolidated financial statements of New Mountain Finance Holdings, L.L.C., formerly known as New Mountain Guardian (Leveraged), L.L.C., and New Mountain Guardian Partners, L.P. are NMF Holdings' historical consolidated financial statements.

Market Data

Statistical and market data used in this prospectus supplement and the accompanying prospectus has been obtained from governmental and independent industry sources and publications. We have not independently verified the data obtained from these sources, and we cannot assure you of the accuracy or completeness of the data. Forward-looking information obtained from these sources is subject to the same qualifications and the additional uncertainties regarding the other forward-looking statements contained in this prospectus supplement and accompanying prospectus. See "Cautionary Statement Regarding Forward-Looking Statements" in this prospectus supplement and the accompanying prospectus.

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THE OFFERING

Common Stock Offered	We are offering 5,000,000 shares of our common stock. To the extent that the underwriters sell more than 5,000,000 shares of our common stock, the underwriters have the option to purchase up to an additional 750,000 shares of our common stock at the initial public offering price, less the underwriting discounts and commissions (sales load), within 30 days of the date of this prospectus supplement.
Shares of Our Common Stock Currently Outstanding	63,864,858 shares.
Shares of Our Common Stock Outstanding After This Offering	68,864,858 shares, excluding 750,000 shares of common stock issuable pursuant to the option to purchase additional shares granted to the underwriters. This amount does not include any shares which may be issuable upon conversion of existing securities.
Use of Proceeds	Our net proceeds from this offering will be approximately $ million, after deducting estimated offering expenses of approximately $0.4 million and underwriting discounts and commissions of approximately $ million payable by us. In addition, the Investment Adviser has agreed to bear $ million of sales load in connection with this offering, which will not be subject to reimbursement by us. If the underwriters' option to purchase additional shares is exercised in full, our net proceeds from this offering will be approximately $ million, after deducting estimated offering expenses of approximately $0.4 million and underwriting discounts and commissions of approximately $ million payable by us. In addition, if the underwriters' option to purchase additional shares is exercised in full, the Investment Adviser has agreed to bear $ million of sales load in connection with this offering, which will not be subject to reimbursement by us. We intend to use the net proceeds from this offering primarily for new investments in portfolio companies in accordance with our investment objective and strategies described in this prospectus supplement and the accompanying prospectus. We may also use a portion of the net proceeds from the sale of shares of our common stock sold in this offering for other general corporate purposes, including to temporarily repay indebtedness (which will be subject to reborrowing), and other working capital requirements. We are continuously identifying, reviewing and, to the extent consistent with our investment objective, funding new investments. As a result, we typically raise capital as we deem appropriate to fund such new investments.

Stockholders' Equity		
Common stock, par value $1 per share	22,472	22,475
Additional paid-in capital	406,292	404,859
Retained earnings	6,549	7,655
	435,313	434,989

Treasury stock		(3,019)	(3,019)
Total stockholders’ equity		432,294	431,970
Total liabilities and stockholders’ equity	$	1,024,433	$ 1,010,144

See notes to consolidated financial statements (unaudited).

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AV HOMES, INC. AND SUBSIDIARIES

Consolidated Statements of Operations

(in thousands, except per share amounts)

(unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
Revenues				
Homebuilding	$ 198,656	$ 196,884	$ 343,801	$ 345,544
Amenity and other	4,289	4,125	9,107	8,762
Land sales	615	185	2,660	2,436
Total revenues	203,560	201,194	355,568	356,742
Expenses				
Homebuilding cost of revenue	164,055	162,600	285,032	285,465
Amenity and other	4,106	3,566	9,350	7,896
Land sales	207	180	438	1,162
Total real estate expenses	168,368	166,346	294,820	294,523
Selling, general and administrative expenses	28,718	27,014	54,233	49,385
Interest income and other	(581)	(253)	(850)	(258)
Interest expense	3,012	3,685	6,403	4,522
Loss on extinguishment of debt	—	2,933	—	2,933
Total expenses	199,517	199,725	354,606	351,105
Income before income taxes	4,043	1,469	962	5,637
Income tax expense	1,044	822	306	2,551
Net income	$ 2,999	$ 647	$ 656	$ 3,086
Basic earnings per share	$ 0.13	$ 0.03	$ 0.03	$ 0.14
Basic weighted average shares outstanding	22,584	22,487	22,577	22,479
Diluted earnings per share	$ 0.13	$ 0.03	$ 0.03	$ 0.14
Diluted weighted average shares outstanding	22,925	22,800	22,908	22,785

See notes to consolidated financial statements (unaudited).

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AV HOMES, INC. AND SUBSIDIARIES

Consolidated Statements of Cash Flows

(in thousands)

(unaudited)

	Six Months Ended June 30, 2018	2017
Operating Activities		
Net income	$ 656	$ 3,086
Adjustments to reconcile net income to net cash used in operating activities:		
Depreciation and amortization	4,261	3,585
Amortization of share-based compensation	1,460	1,529
Change in fair value of contingent consideration	(1,294)	—
Impairment charges	1,222	219
Loss on extinguishment of debt	—	2,933
Deferred income taxes, net	286	2,394
Other adjustments	143	366
Changes in operating assets and liabilities:		
Receivables	9,336	1,327
Land and other inventories	(101,029)	(46,457)
Prepaid expenses and other assets	(4,227)	(4,022)
Accounts payable, estimated development liability, and accrued and other liabilities	6,807	(6,599)
Customer deposits	4,154	5,689
Net cash used in operating activities	(78,225)	(35,950)
Investing Activities		
Investment in property and equipment	(3,685)	(1,256)
Business acquisitions	(42,423)	(41,053)
Other investing activities	—	(12)
Net cash used in investing activities	(46,108)	(42,321)
Financing Activities		
Proceeds from issuance of debt	—	400,000
Gross proceeds from senior secured credit facility	—	30,000
Payments of senior secured credit facility	—	(30,000)
Debt issuance costs	—	(8,091)
Principal payments of senior debt	—	(47,248)
Contingent consideration and other financing activities	(50)	(2,782)
Net cash provided by (used in) financing activities	(50)	341,879
Increase (decrease) in cash, cash equivalents and restricted cash	(124,383)	263,608
Cash, cash equivalents and restricted cash at beginning of period	242,155	69,023

Cash, cash equivalents and restricted cash at end of period	$ 117,772	$ 332,631
Supplemental cash flow information:		
Interest paid, net of capitalized interest	$ 5,017	$ 1,530
Income taxes paid	$ 190	$ 580
Supplemental non-cash investing activity:		
Accrual of contingent consideration as of the acquisition date	$ 2,418	$ 1,818

See notes to consolidated financial statements (unaudited).

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AV HOMES, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements (unaudited)

June 30, 2018

Note 1 - Summary of Significant Accounting Policies

Basis of Presentation

The accompanying consolidated financial statements include the accounts of AV Homes, Inc. and all subsidiaries, partnerships and other entities in which AV Homes, Inc. ("AV Homes," "we," "us," "our," or "the Company") has a controlling interest. The interim consolidated financial statements have been prepared, without audit, pursuant to the rules and regulations of the Securities and Exchange Commission (the "SEC"). Accordingly, they do not include all information and footnotes required by U.S. generally accepted accounting principles ("GAAP") for complete financial statements. These statements reflect all normal and recurring adjustments that, in the opinion of management, are necessary to present fairly the financial position, results of operations and cash flows of AV Homes as of June 30, 2018 and for all periods presented. These statements should be read in conjunction with our consolidated financial statements and notes thereto included in AV Homes' Annual Report on Form 10-K for the year ended December 31, 2017. All significant intercompany accounts and transactions have been eliminated in consolidation. For comparative purposes, certain prior year amounts have been reclassified to conform to the current year presentation. We have no components of comprehensive income; therefore, net income and comprehensive income are the same for the three and six months ended June 30, 2018 and 2017.

Definitive Merger Agreement with Taylor Morrison Home Corporation

On June 7, 2018, we entered into an Agreement and Plan of Merger (the "Merger Agreement") with Taylor Morrison Home Corporation, a Delaware corporation ("Taylor Morrison"), Taylor Morrison Communities, Inc., a Delaware corporation and an indirect subsidiary of Taylor Morrison (the "Intermediate Parent"), and Thor Merger Sub, Inc., a Delaware corporation and an indirect subsidiary of Taylor Morrison (the "Merger Sub"), pursuant to which Merger Sub will be merged with and into the Company (the "Merger"), with AV Homes continuing as the surviving entity in the Merger as an indirect subsidiary of Taylor Morrison. As a result of the merger, we will cease to be a publicly traded company.

Subject to the terms and conditions set forth in the Merger Agreement, at the effective time of the Merger (the "Effective Time"), each issued and outstanding share of common stock, par value $1.00 per share, of AV Homes (the "Company Common Shares") (excluding any shares (i) subject to vesting, repurchase or other lapse restriction granted under a Company equity plan that is outstanding immediately prior to the Effective Time; (ii) held by any stockholder who properly demands and perfects his, her or its appraisal rights with respect to such shares; or (iii) owned directly by the Company (or any wholly owned subsidiary of the Company, Taylor Morrison or Merger Sub immediately prior to the Effective Time)) will be converted into the right to receive and become exchangeable for (A) 0.9793 validly issued, fully paid and nonassessable shares of Class A common stock, $0.00001 par value per share, of Taylor Morrison ("Taylor Morrison Shares"), pursuant to applicable election procedures (subject to the pro ration as described below, the "Stock Election Consideration"); (B) $21.50 in cash, without any interest thereon, pursuant to applicable election procedures (subject to the pro ration as described below, the "Cash Election Consideration"); or (C) $12.64 in cash, without any interest thereon, and 0.4034 validly issued, fully paid and nonassessable Taylor Morrison Shares (the "Mixed Election Consideration" and, together with the Cash Election Consideration and the Stock Election Consideration, the "Merger Consideration"). The per share Cash Election Consideration and Stock Election Consideration are subject to adjustment pursuant to the terms of the Merger Agreement such that the aggregate Merger Consideration will consist of approximately 58.8% cash and approximately 41.2% Taylor Morrison Shares. No fractional Taylor Morrison Shares will be issued in the Merger, and the Company stockholders will receive cash in lieu of any fractional shares.

The completion of the Merger is subject to the satisfaction or waiver of certain customary conditions, including (i) the adoption of the Merger Agreement by our stockholders, (ii) the absence of any law or order prohibiting the Merger, (iii) the effectiveness of the registration statement on Form S-4 filed by Taylor Morrison and the approval for listing on the NYSE of the Taylor Morrison Shares to be issued pursuant to the Merger; (iv) the absence of a material adverse effect on AV Homes and (v) certain other customary conditions relating to the parties' representations and warranties in the Merger Agreement and the performance of their respective obligations. The Merger is not subject to approval by the stockholders of Taylor Morrison or to any financing condition and Taylor Morrison represents and warrants in the Merger Agreement that it will have at the Effective Time cash on hand and available borrowing capacity sufficient in the aggregate to fund all of its payment obligations under the Merger Agreement and in connection with the transactions contemplated under the Merger Agreement, including the Merger.

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The Merger Agreement contains certain termination rights, including (i) in the event that the parties mutually agree to termination, (ii) for either of the Company or Taylor Morrison, if the Merger is not consummated on or before December 7, 2018, (iii) for either of the Company or Taylor Morrison, if any law or order permanently prohibits consummation of the Merger, (iv) for either of the Company or Taylor Morrison, if the requisite approval of the Company's stockholders is not obtained, (v) for either of the Company or Taylor Morrison, if the other party is in breach of its respective representations and warranties or covenants under the Merger Agreement such that a closing condition is not satisfied (subject to notice and cure and other customary exceptions), (vi) for Taylor Morrison, if the Company's board of directors changes its recommendation to the Company's stockholders or (vii) for the Company, in order to enter into an agreement providing for a superior alternative transaction.

The Merger Agreement provides that, in connection with the termination of the Merger Agreement under specified circumstances, the Company may be required to pay to Taylor Morrison a termination fee equal to $18,472,000 in cash.

Concurrently with the execution and delivery of the Merger Agreement, on June 7, 2018, Taylor Morrison and TPG Aviator, LP ("TPG") entered into a voting agreement (the "Voting Agreement") to become effective immediately following approval from the Company's board of directors of the Voting Agreement and the Merger Agreement. Pursuant to the terms of the Voting Agreement, TPG agreed, among other things, to vote all outstanding Company Common Shares currently held or thereafter acquired by TPG in favor of the adoption of the Merger Agreement and against any proposal by third parties to acquire the Company, and to take certain other actions in furtherance of the transactions contemplated by the Merger Agreement, including electing to receive solely Stock Election Consideration, in each case subject to the limitations set forth in the Voting Agreement.

The foregoing description of the Merger Agreement and Voting Agreement is only a summary, does not purport to be complete and is qualified in its entirety by reference to the full text of such agreements, which have been filed as Exhibit 2.1 and Exhibit 99.1, respectively, to our Current Report on Form 8-K that was filed with the SEC on June 7, 2018.

Use of Estimates

The preparation of our consolidated financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates.

Cash and Cash Equivalents and Restricted Cash

We consider all highly liquid investments purchased with an initial maturity of three months or less to be cash equivalents. As of June 30, 2018, our cash and cash equivalents were invested primarily in money market accounts. Due to the short maturity period of the cash equivalents, the carrying amounts of these instruments approximate their fair values.

Our cash items that are restricted as to withdrawal or usage include deposits of $1.8 million and $1.2 million as of June 30, 2018 and December 31, 2017, respectively. Our restricted cash is comprised mainly of customer deposits held in a third-party escrow account and cash held to guarantee our performance to construct improvements in certain communities.

The following table provides a reconciliation of cash, cash equivalents and restricted cash reported within the consolidated balance sheets to the amounts shown in the consolidated statements of cash flows as of June 30, 2018 and 2017 (in thousands):

	June 30, 2018	June 30, 2017
Cash and cash equivalents	$ 115,978	$ 331,227
Restricted cash	1,794	1,404
Total cash, cash equivalents and restricted cash	$ 117,772	$ 332,631

Receivables

Receivables primarily consist of amounts in transit or due from title companies for home closings and for rebates.

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Land and Other Inventories and Homebuilding Cost of Revenue

Land and other inventories include expenditures for land acquisition, land development, home construction, construction costs for amenities, and direct and allocated indirect costs, including interest cost capitalized until development and construction are substantially completed. These costs are assigned to components of land and other inventories based on specific identification, relative sales value, or area allocation methods.

Land and other inventories are stated at cost unless the asset is determined to be impaired, in which case the asset is written to its fair value, in accordance with Accounting Standards Codification (“ASC”) 360, Property, Plant and Equipment (“ASC 360”).

Homebuilding cost of revenue is comprised of direct and allocated costs, including estimated future costs for the limited warranty we provide on our homes. Land acquisition, land development and other common costs are generally allocated on a relative sales value or area allocation basis to the homes or lots within the applicable community or land parcel. Land acquisition and land development costs include related interest and real estate taxes during the period of time under development.

We evaluate our land and other inventories for impairment on a quarterly basis in accordance with ASC 360 to reflect market conditions, including a consideration of supply of new and resale homes for sale in the respective market, level of foreclosure activity and competition. For assets held and used, if indicators are present, we perform an impairment test by comparing the estimated future undiscounted cash flows to be generated by the asset to its carrying value. If such cash flows are less than the asset’s carrying value, the carrying value is written down to its estimated fair value. Generally, fair value is determined by discounting the estimated cash flows at a rate commensurate with the inherent risks associated with the asset and related estimated cash flow streams. The discount rate used in the determination of fair value would vary, depending on the state of development. Assumptions and estimates used in the determination of the estimated future cash flows are based on several factors, including expectations of future operations and economic conditions. Changes to these assumptions could significantly affect the estimates of future cash flows, which could affect the potential for future impairments. Due to the uncertainties of the estimation process, actual results could differ significantly from such estimates.

During the three and six months ended June 30, 2018, our impairment assessments resulted in $0.6 million and $1.2 million of impairment charges, respectively, and are included in homebuilding cost of revenue in the consolidated statements of operations. During the three and six months ended June 30, 2017, our impairment assessments resulted in $0.1 million and $0.2 million, respectively.

Property and Equipment, net

Property and equipment, net are stated at cost less accumulated depreciation, and depreciation is computed by the straight-line method over the following estimated useful lives of the assets: land improvements 5 to 15 years; buildings and improvements 3 to 40 years; and machinery, equipment and fixtures 3 to 10 years. Maintenance and operating expenses of equipment utilized in the development of land are capitalized to land inventory. All other repairs and maintenance are expensed as incurred.

Property and equipment includes amenity assets such as club facilities on properties we own. The cost of amenity assets includes expenditures for land acquisition, construction, land development and direct and allocated costs. Property and equipment owned and constructed by us also includes interest cost incurred during development and construction.

Each reporting period, we review our property and equipment for indicators of impairment in accordance with ASC 360. For our amenities, which are located within our housing communities, indicators of impairment are similar to those of our housing communities (described above), as these factors may impact our ability to generate revenues at our amenities or cause construction costs to increase. In addition, we factor in the collectability and potential delinquency of the fees due for our amenity memberships. During the three and six months ended June 30, 2018 and 2017, we did not identify indicators of impairment for our property and equipment.

Investments in Unconsolidated Entities

We participate in entities in which we own less than 100% of the equity interests. One entity in which we have a 58% equity interest was formed for the purpose of acquiring and developing land in our Encore active adult community in Arizona, while the other is a mortgage joint venture in which we have a 50% equity interest that was formed in the fourth quarter of 2017 to serve as a preferred lender for homebuyers in our markets, along with other related services.

We determine the method for accounting for our investments at inception or upon a reconsideration event. We share in the profits and losses of unconsolidated entities generally in accordance with our ownership interests. Earnings from investments in unconsolidated entities is included within interest income and other in our consolidated statements of operations. We and our equity partners make initial and ongoing capital contributions to these unconsolidated entities on a pro-rata basis. The obligation to make capital contributions is governed by each unconsolidated entity's respective operating agreement or other governing documents. The balance of our investments in unconsolidated entities was $0.2 million and $0.3 million as of June 30, 2018 and December 31, 2017, respectively, and is included in prepaid expenses and other assets in our consolidated balance sheets.

Goodwill

Goodwill arises from business combinations and represents the excess of the consideration transferred for an acquired entity over the net fair value amounts that were assigned to the identifiable assets acquired and the liabilities assumed. Goodwill is tested for impairment at the reporting unit level on an annual basis and between annual tests if an event occurs or circumstances change that would more likely than not reduce the fair value of the reporting unit below its carrying value. There were no indicators of impairment during the three and six months ended June 30, 2018 and 2017.

Revenue Recognition

We recognize homebuilding, amenity and land sales revenues in accordance with ASC 606, Revenue from Contracts with Customers ("ASC 606"), which requires revenue to be recognized in a manner to depict the transfer of goods or services to a customer at an amount that reflects the consideration expected to be received in exchange for those goods or services.

Our homebuilding contracts require us to construct and deliver homes to our customers. The transaction price is stated in the final sales contract that is signed by the customer. Homebuilding revenue is recognized at closing when payment is due and when title to and possession of the property are transferred to the homebuyer.

We own and operate certain amenities pursuant to recorded mandatory club plans, which require us to provide members with access to amenity facilities in exchange for the payment of club dues. We collect club dues and other fees from our members, which are billed on a monthly basis. Our performance obligation is to make available the club amenities on an ongoing basis. Accordingly, we recognize revenue over the period for which dues have been paid. Revenue from our golf club operations is also included in amenity revenue and is recognized as the service is provided.

Our contracts for sales of land involve the selling of real property. The transaction price is stated in the final sales contract that is signed by the customer. Land sales revenue is recognized at closing when payment is due and when title to and possession of the real property are transferred to the buyer.

We report our revenue from contracts with customers by type of good or service and by geographical regions, as we believe this achieves the disclosure objective to depict how the nature, amount, timing and uncertainty of revenue and cash flows are affected by economic factors. See the accompanying consolidated statements of operations and segment operating statements in Note 7, Segment Information, for our disaggregated revenue disclosures.

We have contract assets that consist of cash from home closings held in escrow for our benefit, typically for less than five days, which are considered deposits in-transit and classified as cash. Contract liabilities include earnest money deposits collected from home or land buyers pursuant to our written sales contracts. These deposits remain classified as liabilities and are recognized as revenue at the time of closing when full payment is received. If a contract is cancelled by a customer and the related deposit is non-refundable, the deposit is recognized as homebuilding or land sales revenue. See the accompanying consolidated balance sheets for our customer deposits balances as of June 30, 2018 and December 31, 2017. During the three and six months ended June 30, 2018, we recognized $4.5 million and $8.7 million, respectively, of homebuilding revenue that

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was included in our customer deposit liability balance as of December 31, 2017. See Warranty Costs within this Note 1, Summary of Significant Accounting Policies, for information on warranties and related obligations.

A number of practical expedients are available in the application of the recognition and measurement principles with ASC 606. We have elected to apply the portfolio approach to our homebuilding and amenity contracts rather than evaluating individual contracts since the characteristics of each type of contract are similar. We reasonably expect that this election will not be materially different from the impact of applying ASC 606 on an individual contract basis. In addition, since our homebuilding and land sale contracts are typically completed in less than a year, we have not disclosed the transaction price for the remaining performance obligations as of the end of each reporting period or when we expect to recognize this revenue. For amenity contracts, we have elected to use the invoice practical expedient since we determined that we have a right to invoice an amount that corresponds directly with the value to the customer of our performance completed to date. See Recent Accounting Pronouncements within this Note 1, Summary of Significant Accounting Policies, for further discussion.

Sales Incentives

When sales incentives involve a discount on the selling price of the home, we record the discount as a reduction of revenue at the time of home closing. If the sales incentive requires us to provide a free product or service to the customer, the cost of the free product or service is recorded as homebuilding cost of revenue at the time of home closing. This includes the cost related to optional upgrades and seller-paid financing costs, closing costs, homeowners' association fees, or merchandise.

Advertising Costs

Advertising costs are expensed as incurred. During the three and six months ended June 30, 2018, advertising costs were $1.0 million and $2.0 million, respectively. During the three and six months ended June 30, 2017, advertising costs were $1.0 million and $1.9 million, respectively. Advertising costs, sales commissions and closing costs are included in selling, general and administrative expenses in the accompanying consolidated statements of operations.

Warranty Costs

Warranty reserves for homes are established to cover estimated costs for materials and labor with regard to warranty-type claims to be incurred subsequent to the closing of a home. Reserves are determined based on historical data and other relevant factors. We have, and require our subcontractors to have, general liability, property, workers' compensation, and other business insurance. These insurance policies protect us against a portion of our risk of loss from claims, subject to certain self-insured per occurrence and aggregate retentions, deductibles, and available policy limits. We may have recourse against subcontractors for certain claims relating to workmanship and materials. Warranty reserves are included in accrued and other liabilities in the accompanying consolidated balance sheets.

During the three and six months ended June 30, 2018 and 2017, changes in the warranty reserve consisted of the following (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
Accrued warranty reserve, beginning of period	$ 4,623	$ 3,490	$ 4,916	$ 4,033
Reserve provided	1,363	1,393	2,360	1,809
Payments	(1,280)	(1,019)	(2,570)	(1,978)
Accrued warranty reserve, end of period	$ 4,706	$ 3,864	$ 4,706	$ 3,864

Income Taxes

Our effective tax rate for the three and six months ended June 30, 2018 was 25.8% and 31.8%, respectively. Our effective tax rate for the three and six months ended June 30, 2017 was 55.9% and 45.3%, respectively. Our effective tax rate is impacted by a number of factors, the most significant of which is the enactment of the Tax Cuts and Jobs Act (“TCJA”) on December 22, 2017. In accordance with Staff Accounting Bulletin No. 118 (“SAB 118”), we remeasured the deferred tax assets as of December 31, 2017, based on the corporate income tax rate change from 35% to 21%. As of June 30, 2018, we have not recorded any adjustments to these estimates. We expect our final accounting for the TCJA under SAB 118 to be completed in the third quarter of 2018 when the 2017 income tax returns are filed.

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We evaluate our deferred tax assets each period to determine if a valuation allowance is required based on whether it is “more likely than not” that some portion of the deferred tax assets would not be realized. The ultimate realization of these deferred tax assets is dependent upon the generation of sufficient taxable income during future periods. We conduct our evaluation by considering all available positive and negative evidence. This evaluation considers, among other factors, historical operating results, forecasts of future profitability, the duration of statutory carryforward periods, and the outlooks for the U.S. housing industry and broader economy. As of June 30, 2018, we do not have a valuation allowance related to our deferred tax assets.

The accounting for deferred taxes is based upon estimates of future results. Differences between estimated and actual results could result in changes in the valuation of our deferred tax assets that could have a material impact on our consolidated results of operations or financial position. Changes in existing tax laws could also affect actual tax results and the realization of deferred tax assets over time.

Unrecognized tax benefits represent the difference between tax positions taken or expected to be taken in a tax return and the benefits recognized for financial statement purposes. As of June 30, 2018, we had no unrecognized tax benefits.

Any interest or penalties assessed have been immaterial to our financial results. In the event we are assessed any interest or penalties in the future, we plan to include them in our consolidated statements of operations as income tax expense.

Share-Based Compensation

The Amended and Restated 1997 Incentive and Capital Accumulation Plan (2011 Restatement), as amended (“Incentive Plan”), and the 2015 Incentive Compensation Plan (the “2015 Plan”) provide for the grant of stock options, stock appreciation rights, stock awards, performance awards, and stock units to officers, employees and directors of AV Homes. The exercise prices of stock options granted under the Incentive Plan and the 2015 Plan may not be less than the stock exchange closing price of our common stock on the date of grant. Stock option awards under the Incentive Plan and 2015 Plan generally expire 10 years after the date of grant.

As of June 30, 2018, there were an aggregate of 1.2 million shares available for grant under the 2015 Plan and 0.7 million shares reserved for future issuance relating to stock options, performance share units, and restricted stock units previously awarded and currently outstanding under the 2015 Plan. Additionally, as of June 30, 2018, an aggregate of 0.4 million shares of our common stock were reserved for future issuance in connection with options and restricted stock units previously awarded under the Incentive Plan.

Earnings Per Share

Basic earnings per share is computed by dividing net income by the weighted average number of common shares outstanding for the period. Diluted earnings per share reflects the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock or resulted in the issuance of common stock that then shared in the earnings of AV Homes. The computation of diluted earnings per share for the three and six months ended June 30, 2018 did not assume the effect of convertible notes because the effects were antidilutive. The computation of diluted earnings per share for the three and six months ended June 30, 2017 did not assume the effect of employee stock options or convertible notes because the effects were antidilutive.

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The following table represents a reconciliation of the net income and weighted average shares outstanding for the calculation of basic and diluted earnings per share for the three and six months ended June 30, 2018 and 2017 (in thousands, except per share amounts):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
Numerator:				
Basic net income	$ 2,999	$ 647	$ 656	$ 3,086
Effect of dilutive securities	—	—	—	—
Diluted net income	$ 2,999	$ 647	$ 656	$ 3,086
Denominator:				
Basic weighted average shares outstanding	22,584	22,487	22,577	22,479
Effect of dilutive securities	341	313	331	306
Diluted weighted average shares outstanding	22,925	22,800	22,908	22,785
Basic earnings per share	$ 0.13	$ 0.03	$ 0.03	$ 0.14
Diluted earnings per share	$ 0.13	$ 0.03	$ 0.03	$ 0.14

Recent Accounting Pronouncements

In January 2017, the FASB issued ASU No. 2017-01, Business Combinations (Topic 805), Clarifying the Definition of a Business ("ASU 2017-01"). ASU 2017-01 clarifies the definition of a business with the objective of addressing whether transactions involving in-substance nonfinancial assets, held directly or in a subsidiary, should be accounted for as acquisitions or disposals of nonfinancial assets or of businesses. ASU 2017-01 was effective for us for the fiscal year and interim periods beginning January 1, 2018 and was applied prospectively. The adoption of ASU 2017-01 did not have a material impact on our consolidated financial statements.

In August 2016, the FASB issued ASU No. 2016-15, Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments ("ASU 2016-15"). ASU 2016-15 reduces the existing diversity in practice in financial reporting across all industries by clarifying certain existing principles in ASC 230, Statement of Cash Flows ("ASC 230"), including providing additional guidance on how and what an entity should consider in determining the classification of certain cash flows. Additionally, in November 2016, the FASB issued ASU No. 2016-18, Statement of Cash Flows (Topic 230), Restricted Cash ("ASU 2016-18"). ASU 2016-18 clarifies certain existing principles in ASC 230, including providing additional guidance related to transfers between cash and restricted cash and how entities present, in their statement of cash flows, the cash receipts and cash payments that directly affect the restricted cash accounts. Both ASU 2016-15 and ASU 2016-18 were effective for us for the fiscal year and interim periods beginning January 1, 2018 and were applied on a retrospective basis. The adoption of ASU 2016-15 and ASU 2016-18 resulted in changes in the presentation of certain items within the consolidated statements of cash flows, including the presentation of restricted cash, which decreased net cash used in operating activities by $0.2 million during the six months ended June 30, 2017. The adoption did not have a material impact on our consolidated financial statements.

In February 2016, the FASB issued ASU No. 2016-02, Leases (Topic 842) (“ASU 2016-02”). ASU 2016-02 will require organizations that lease assets–referred to as “lessees”–to recognize on the balance sheet the assets and liabilities for the rights and obligations created by those leases. Under ASU 2016-02, a lessee will be required to recognize assets and liabilities for leases with lease terms of more than twelve months. Lessor accounting remains substantially similar to current GAAP. In addition, disclosures of leasing activities are to be expanded to include qualitative along with specific quantitative information. ASU 2016-02 is effective for us for fiscal years and interim periods beginning January 1, 2019. The standard mandates a modified retrospective transition method. We continue to evaluate the impact of adopting this guidance on our consolidated financial statements.

In May 2014, the FASB issued ASU No. 2014-09, Revenue from Contracts with Customers (“ASU 2014-09”). The standard is a comprehensive new revenue recognition model that requires revenue to be recognized in a manner to depict the transfer of goods or services to a customer at an amount that reflects the consideration expected to be received in exchange for those goods or services. ASU 2014-09 also affects certain industry-specific cost guidance. The FASB has also issued several updates to this standard. The standard was effective for us for annual and interim periods beginning January 1, 2018.

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We have applied the provisions of ASU 2014-09 on a modified retrospective basis to contracts that were not completed as of January 1, 2018 and concluded that there was no material change to the amount or timing of our homebuilding, amenity and other, and land sales revenues. Our homebuilding revenue currently includes forfeited customer deposits and did not change under the new standard. However, the standard impacted the timing of recognition for certain selling costs related to model homes and sales offices. Prior to the adoption of ASU 2014-09, for selling communities, these costs were capitalized as land and other inventories and expensed as homes in the communities were closed in accordance with ASC 970-340. Upon adoption of ASC 2014-09, these capitalized selling costs were recorded as property and equipment in the amount of $5.3 million, while the remaining costs that would have been expensed under the new guidance are reflected as a $1.8 million reduction of retained earnings on January 1, 2018.

Note 2 - Business Acquisitions

On January 8, 2018, we acquired substantially all of the assets and assumed certain liabilities of MMLC Texas Builders, LLC (“Oakdale-Hampton Homes”) for $44.8 million, including an earn-out, which remains subject to customary post-closing adjustments. A portion of the aggregate consideration equal to $0.6 million was placed in a third-party escrow account as security for Oakdale-Hampton Homes’ indemnification and other obligations under the purchase agreement. Oakdale-Hampton Homes acquires developed land and constructs single-family homes in the Dallas-Fort Worth, Texas area. This acquisition marks our entry into a new key growth market. The results of Oakdale-Hampton’s operations are included in our consolidated financial statements from the acquisition date of January 8, 2018.

The Oakdale-Hampton Homes acquisition was accounted for in accordance with ASC 805, Business Combinations (“ASC 805”). We recorded the acquired assets and liabilities at their estimated fair values. We determined the estimated fair values with the assistance of appraisals or valuations performed by independent third-party specialists, discounted cash flow analyses, quoted market prices where available, and estimates by management. To the extent the consideration transferred exceeded the fair value of the net assets acquired in this transaction, such excess was assigned to goodwill.

The following table summarizes the calculation of the fair value of the total consideration transferred to Oakdale-Hampton Homes and its preliminary allocation to the assets acquired and liabilities assumed as of the acquisition date (in thousands):

Fair value of consideration transferred:

Cash paid for net assets	$ 42,423
Contingent consideration (earn-out)	2,418
Total consideration transferred	$ 44,841
Assets acquired and liabilities assumed:	
Assets	
Receivables and other assets	$ 719
Land and other inventories	34,933
Property and equipment	798
Trade name	560
Goodwill	8,733
Total assets acquired	45,743
Liabilities	
Accounts payable	749
Accrued and other liabilities	84
Customer deposits	69
Total liabilities assumed	902
Total net assets acquired	$ 44,841

Fair Value

Receivables and other assets, property and equipment, accounts payable and accrued and other liabilities were generally stated at historical carrying values given the short-term nature of these assets and liabilities.

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We determined the fair value of land and other inventories on a lot-by-lot basis primarily using market comparable land and home sales transactions combined with our estimates related to expected average home selling prices and sales incentives, expected sales paces and cancellation rates, expected land development and construction timelines, and anticipated land development, construction, and overhead costs. Such estimates must be made for each individual community and may vary significantly between communities. The fair values of identified intangible assets were determined using discounted cash flow models.

The $0.6 million of acquired intangible assets relates to trade names that are being amortized over 2.5 years. Amortization expense for the three and six months ended June 30, 2018 was $0.1 million for each period, and is included in selling, general and administrative expenses in the consolidated statements of operations.

We estimated the preliminary fair value of acquired assets and liabilities as of the date of acquisition based on information available at that time. The valuation of these tangible and identifiable intangible assets and liabilities is subject to further management review and may change.

Transaction and Integration Costs

Transaction and integration costs directly related to the Oakdale-Hampton Homes acquisition, including legal and accounting fees, were expensed as incurred in accordance with ASC 805.

Goodwill

As of the acquisition date, goodwill consisted primarily of the expected economic value attributable to gaining access to a new market with immediate revenue opportunities through an established backlog and assembled workforce. All of the goodwill is expected to be deductible for income tax purposes and is assigned to the Texas reporting segment.

Supplemental Pro Forma Information

The following represents pro forma operating results as if Oakdale-Hampton Homes had been included in our consolidated statements of operations as of the beginning of the fiscal year presented (in thousands, except per share data):

	Three Months Ended June 30, 2017	Six Months Ended June 30, 2017
Revenue	$ 212,481	$ 383,643
Net income	1,391	5,052
Basic earnings per share	0.06	0.22
Diluted earnings per share	0.06	0.22

The supplemental pro forma operating results have been determined after adjusting the operating results of Oakdale-Hampton Homes to reflect additional expense that would have been recorded assuming the fair value adjustments to inventory and intangible assets had been applied as of January 1, 2017. These results may not be indicative of future operating results.

Note 3 - Land and Other Inventories

As of June 30, 2018 and December 31, 2017, land and other inventories consisted of the following (in thousands):

	June 30, 2018	December 31, 2017
Land held for future development	$ 29,760	$ 29,312
Land developed and in process of development	387,056	351,798
Homes completed or under construction	314,736	222,741
Total	$ 731,552	$ 603,851

We capitalize interest to inventories during the period of development in accordance with ASC 835, Interest (“ASC 835”). Homebuilding interest capitalized to inventory is included in homebuilding cost of revenue as related units or lots are closed. To the extent our homebuilding debt exceeds our qualified assets, as defined in ASC 835, we expense a portion of interest incurred. Qualified homebuilding assets consist of land, lots and homes that are under development or construction, excluding finished unsold homes or finished models.

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The following table represents interest incurred, interest capitalized, and interest expense for the three and six months ended June 30, 2018 and 2017 (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
Interest incurred	$ 8,518	$ 9,318	$ 17,036	$ 15,523
Interest capitalized	(5,506)	(5,633)	(10,633)	(11,001)
Interest expense	$ 3,012	$ 3,685	$ 6,403	$ 4,522

Note 4 - Senior Debt

As of June 30, 2018 and December 31, 2017, senior debt, net consisted of the following (in thousands):

	June 30, 2018	December 31, 2017
6.625% Senior Notes due 2022	$ 400,000	$ 400,000
6.00% Senior Convertible Notes due 2020	80,000	80,000
Senior Unsecured Credit Facility	—	—
Total senior debt	480,000	480,000
Deferred debt issuance costs	(6,883)	(7,853)
Debt discount	(31)	(39)
Total senior debt, net	$ 473,086	$ 472,108

6.625% Senior Notes due 2022

On May 18, 2017, we completed a private offering of $400.0 million of our 6.625% Senior Notes due 2022 (the “6.625% Notes”). The proceeds of the 6.625% Notes were used to (i) fund the repurchase and redemption of the $200.0 million in aggregate principal amount of our outstanding 8.50% Senior Notes due 2019 and (ii) pay amounts outstanding under our senior secured credit facility, totaling $30.0 million. We intend to use the remaining proceeds for general corporate purposes, which may include the financing of acquisitions. The 6.625% Notes mature on May 15, 2022, unless earlier redeemed or repurchased. Interest on the 6.625% Notes is payable semi-annually in arrears in cash on May 15 and November 15 of each year, commencing November 15, 2017.

We have the option to redeem all or a portion of the 6.625% Notes at any time on or after May 15, 2019 at certain redemption prices, plus accrued and unpaid interest, if any, to but excluding the date of redemption. At any time prior to May 15, 2019, we have the option to redeem up to 35% of the original principal amount of the 6.625% Notes with the proceeds of certain equity offerings by us at a redemption price of 106.625% of the principal amount of the 6.625% Notes, plus accrued and unpaid interest, if any, to but excluding the date of redemption, provided that at least 65% of the original aggregate principal amount of the 6.625% Notes remains outstanding after such redemption. Prior to May 15, 2019, we may redeem some or all of the 6.625% Notes at a redemption price equal to 100% of the principal amount of the 6.625% Notes, plus accrued and unpaid interest, if any, to but excluding the applicable redemption date plus the applicable "make-whole" premium.

The indenture governing the 6.625% Notes contains covenants that limit our ability and the ability of certain of our subsidiaries to (i) pay dividends, or make other distributions or redeem or repurchase our capital stock; (ii) prepay, redeem or repurchase certain debt; (iii) incur additional and guarantee indebtedness; (iv) issue certain preferred stock or similar equity securities; (v) make loans and investments; (vi) incur liens; (vii) sell assets; (viii) enter into transactions with affiliates; (ix) enter into agreements restricting our subsidiaries' ability to pay dividends; and (x) consolidate, merge or sell all or substantially all assets. These covenants are subject to important exceptions and qualifications.

The indenture further provides that upon certain specified change of control events, certain covenants will no longer apply to the 6.625% Notes and will be replaced with new covenants (a "Covenant Replacement Event"). Additionally, if we experience specific kinds of changes in control that do not result in a Covenant Replacement Event or, if following a Covenant Replacement Event, we experience a subsequent change of control that results in a downgrade of the rating assigned to the 6.625% Notes, holders of the 6.625% Notes will be entitled to require us to purchase all or a portion of the 6.625% Notes at 101% of their principal amount, plus accrued and unpaid interest to but excluding the date of repurchase.

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6.00% Senior Convertible Notes due 2020

On June 23, 2015, we completed a private offering of $80.0 million aggregate principal amount of 6.00% Senior Convertible Notes due 2020 (the "6.00% Notes"). The proceeds of the 6.00% Notes were used to (i) repurchase 7.50% Senior Exchange Convertible Notes due 2016 and 7.50% Senior Convertible Notes due 2016 and (ii) pay approximately $1.5 million of accrued interest (in respect of the notes being exchanged or repurchased) and premium (in respect of the notes being repurchased). The 6.00% Notes will mature on July 1, 2020, unless earlier repurchased or converted. The 6.00% Notes are governed by the Indenture dated February 4, 2011 and the Third Supplemental Indenture dated June 23, 2015 between us and the trustee named therein. The 6.00% Notes bear regular cash interest on the principal amount of each note, payable semi-annually in arrears on January 1 and July 1 of each year, beginning on January 1, 2016.

The 6.00% Notes were issued pursuant a series of separate, privately negotiated note purchase agreements entered into on June 17, 2015 by us and certain qualified institutional buyers. TPG Aviator, L.P. ("TPG") purchased $20.0 million aggregate principal amount of the 6.00% Notes for $20.0 million in cash and waived its rights to purchase additional 6.00% Notes, resulting in a fully diluted beneficial ownership for TPG of approximately 43.8% of our common stock at the time of the transaction. Pursuant to the terms of our Related Person Transaction Policy, the audit committee of our board of directors reviewed and approved the terms of the 6.00% Notes and TPG's purchase of 6.00% Notes.

Senior Unsecured Credit Facility

On May 18, 2017, we entered into an unsecured revolving credit agreement (the "Senior Unsecured Credit Facility") with each of the financial institutions party thereto, JPMorgan Chase Bank, N.A., as administrative agent, and Citibank, N.A., as syndication agent.

The Senior Unsecured Credit Facility includes a revolving credit facility in an aggregate principal amount of up to $155.0 million, with an "accordion" feature that allows us, with the consent of the lenders, to increase the aggregate amount to $250.0 million. The facility includes a letter of credit sub-facility in an amount equal to 50% of total commitments then in effect. The maximum amount available under the Senior Unsecured Credit Facility is limited to the lesser of (i) $155.0 million (subject to increase pursuant to the "accordion") and (ii) an amount equal to the borrowing base minus our consolidated senior debt. As of June 30, 2018, we had sufficient qualified assets in the borrowing base to cover borrowings of up to $149.2 million and had no borrowings outstanding.

Interest is payable on revolving credit borrowings at variable rates determined by the applicable LIBOR plus 3.25% or the prime rate plus 2.25%, at our election. We pay quarterly fees of 0.50% per annum on the unused portion of the lenders' commitments under the Senior Unsecured Credit Facility to the lenders.

The Senior Unsecured Credit Facility expires on July 28, 2020. Upon expiration, all borrowings become due and payable. We may prepay loans borrowed under the Senior Unsecured Credit Facility or reduce the commitments thereunder at our option, without any prepayment fee or penalty.

The Senior Unsecured Credit Facility is guaranteed by certain of our subsidiaries, and we have the option to add or remove guarantors from time to time, subject to certain limitations.

We were in compliance with all financial covenants as of June 30, 2018.

Note 5 - Estimated Development Liability

The estimated development liability consists primarily of utility completion obligations in Rio Rico, Arizona and Poinciana, Florida for more than 8,000 home sites previously sold, prior to 1980. The estimated development liability is reduced by actual expenditures and is evaluated and adjusted, as appropriate, to reflect management's estimate of potential costs. In addition, we obtain third-party engineer evaluations on an annual basis and adjust this liability to reflect changes in the estimated completion costs. Cash expenditures associated with these obligations were $0.1 million and $0.2 million during the three and six months ended June 30, 2018, respectively, and were $0.2 million and $0.3 million during the three and six months ended June 30, 2017, respectively. Future increases or decreases of costs for construction, material and labor, as well as other land development and utilities infrastructure costs, may have a significant effect on the estimated development liability. The balance of the estimated development liability was $31.4 million and $31.6 million as of June 30, 2018 and December 31, 2017, respectively.

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Note 6 - Commitments and Contingencies

Legal

We are involved in litigation from time to time, primarily arising in the normal course of our business. These cases are in various procedural stages. In view of the inherent difficulty of predicting the outcome of these legal and regulatory matters, we generally cannot predict the ultimate resolution of the pending matters, the related timing, or the eventual loss. While the outcome of such contingencies cannot be predicted with certainty, we do not believe that the resolution of such matters will have a material adverse impact on our results of operations, financial position, or cash flows.

On April 26, 2017, we received notice of a Class Action Complaint filed in the Circuit Court for the 10th Judicial Circuit, Polk County, Florida, generally alleging that the collection of club membership fees in connection with the use and enjoyment of the club facilities located within the Solivita community is illegal in that it violates, among other laws, Florida's Homeowners' Association Act ("FLHOA") and Florida's Deceptive and Unfair Trade Practices Act ("FDUTPA"). It also generally alleges that certain other actions by us have violated FLHOA and FDUTPA. The complaint seeks relief in various forms including recovery for the prior payment of club membership fees and an injunction to prohibit the future collection of club membership fees. On June 9, 2017, we filed an amended motion to dismiss this matter, which was heard on June 13, 2017. On August 8, 2017, the judge issued an order denying in part and granting in part the motion to dismiss. Plaintiffs were provided leave to amend the FDUTPA claims and filed an amended complaint on September 15, 2017. We filed our amended answer on September 29, 2017 along with certain affirmative defenses. The amended answer also contains counterclaims against the plaintiffs for breach of contract and tortious interference with contractual relations, among other claims. On October 5, 2017, we also filed a motion for summary judgment, which was heard on December 8, 2017. On January 23, 2018, the court ruled, granting our motion for summary judgment in part and denying it in part. Importantly, the court ruled that our club operations in Solivita constitute commercial property under the FLHOA, that the club facilities are not common areas of the homeowners' association and that nothing in the FLHOA prevents a developer from owning club operations for profit, as is the case in this instance. On April 6, 2018, the court heard arguments relative to the plaintiffs' amended motion for class certification pursuant to which the plaintiffs sought to certify a class of "persons who currently own, or previously owned, a home in Solivita, who have paid, or have been obligated to pay, a Club Membership Fee under the Club Plan Declaration on or after April 26, 2013." On June 29, 2018, the court ruled on plaintiffs' amended motion for class certification, granting class certification as to three counts and partially as to a fourth count and denying class certification as to the remaining eight counts of plaintiffs' amended complaint, but not otherwise making any dispositive rulings as to the merits of the plaintiffs' counts. In the ruling, the court also redefined and limited the class being certified to include only those persons who currently own a home in Solivita and who have paid a Club Membership Fee under the Club Plan on or after April 26, 2013.

On July 24, 2018, a putative stockholder class action lawsuit captioned Lawrence Zucker v. AV Homes, Inc. et al., Case 1:18-cv-01091, was filed in the United States District Court for the District of Delaware against AV Homes, the members of the AV Homes Board and Taylor Morrison pursuant to Sections 14(a) and 20(a) of the Securities Exchange Act. The complaint alleges, among other things, that the disclosures set forth in the preliminary proxy statement/prospectus filed in connection with the Merger on July 13, 2018 are insufficient and allegedly fail to disclose material information about the combination. The complaint seeks, among other remedies, injunctive relief prohibiting the stockholder vote contemplated by the Merger Agreement, an accounting of damages sustained by the stockholders comprising the purported class and an award of attorneys' fees and expenses. We believe that the action is without merit.

Surety Bonds

Surety bonds, issued by third-party entities, are used primarily to guarantee our performance to construct improvements in our various communities. As of June 30, 2018, we had outstanding surety bonds of approximately \$50 million. The amount of outstanding surety bonds could fluctuate depending on the level of development activity. We do not believe that it is likely any of these outstanding surety bonds will be drawn upon.

Note 7 - Segment Information

Our operating segments are defined as a component of an enterprise for which discrete financial information is available and is reviewed regularly by the chief operating decision maker to evaluate performance and make operating decisions. We have identified our chief operating decision maker as our Chief Executive Officer. Our reportable segments are as follows: Florida, the Carolinas, Arizona and Texas.

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The following table summarizes our information for reportable segments for the three and six months ended June 30, 2018 and 2017 (in thousands):

	Three Months Ended June 30, 2018	2017	Six Months Ended June 30, 2018	2017
Operating income:				
Florida				
Revenues:				
Homebuilding	$ 74,140	$ 79,112	$ 132,243	$ 149,599
Amenity and other	4,289	4,125	9,107	8,762
Land sales	615	—	2,660	1,469
Total revenues	79,044	83,237	144,010	159,830
Expenses:				
Homebuilding cost of revenue	58,540	62,640	103,617	118,634
Homebuilding selling, general and administrative	9,313	9,106	18,415	18,404
Amenity and other	4,088	3,548	9,310	7,855
Land sales	207	—	438	196
Segment operating income	$ 6,896	$ 7,943	$ 12,230	$ 14,741
Carolinas				
Revenues:				
Homebuilding	$ 76,119	$ 82,517	$ 130,023	$ 129,362
Land sales	—	—	—	782
Total revenues	76,119	82,517	130,023	130,144
Expenses:				
Homebuilding cost of revenue	65,470	70,048	113,633	110,181
Homebuilding selling, general and administrative	8,173	9,140	15,130	14,163
Land sales	—	—	—	786
Segment operating income	$ 2,476	$ 3,329	$ 1,260	$ 5,014
Arizona				
Revenues:				
Homebuilding	$ 39,736	$ 35,255	$ 64,982	$ 66,583
Land sales	—	185	—	185
Total revenue	39,736	35,440	64,982	66,768
Expenses:				
Homebuilding cost of revenue	32,698	29,912	53,832	56,650
Homebuilding selling, general and administrative	4,269	3,782	7,394	7,153
Amenity and other	18	18	40	41
Land sales	—	180	—	180
Segment operating income	$ 2,751	$ 1,548	$ 3,716	$ 2,744
Texas				
Revenues:				
Homebuilding	$ 8,661	$ —	$ 16,553	$ —

Total revenue	8,661	—	16,553	—
Expenses:				
Homebuilding cost of revenue	7,347	—	13,950	—
Homebuilding selling, general and administrative	1,954	—	3,541	—
Segment operating loss	$ (640)	$ —	$ (938)	$ —
Operating income	$ 11,483	$ 12,820	$ 16,268	$ 22,499
Unallocated income (expenses):				
Interest income and other	581	253	850	258
Corporate general and administrative expenses	(5,009)	(4,986)	(9,753)	(9,665)
Loss on extinguishment of debt	—	(2,933)	—	(2,933)
Interest expense	(3,012)	(3,685)	(6,403)	(4,522)
Income before income taxes	4,043	1,469	962	5,637
Income tax expense	1,044	822	306	2,551
Net income	$ 2,999	$ 647	$ 656	$ 3,086

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Note 8 - Fair Value Disclosures

ASC 820, Fair Value Measurements and Disclosures (“ASC 820”), provides guidance for using fair value to measure assets and liabilities, defines fair value, establishes a framework for measuring fair value under GAAP, expands disclosures about fair value measurements, and establishes a fair value hierarchy that requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value.

The accounting standards require that assets and liabilities carried at fair value be classified and disclosed in one of the following three categories:

Level 1: Fair value determined based on quoted market prices in active markets for identical assets and liabilities.

Level 2: Fair value determined using significant observable inputs, such as quoted prices for similar assets or liabilities or quoted prices for identical or similar assets or liabilities in markets that are not active, inputs other than quoted prices that are observable for the asset or liability, or inputs that are derived principally from or corroborated by observable market data, by correlation or other means.

Level 3: Fair value determined using significant unobservable inputs, such as discounted cash flows, or similar techniques.

The carrying amounts of cash and cash equivalents, restricted cash, receivables, accounts payable, and the Senior Unsecured Credit Facility approximate the fair values due to their short-term nature.

Certain assets are required to be recorded at fair value on a non-recurring basis when events and circumstances indicate that the carrying value may not be recoverable.

The carrying amounts and fair values of our financial liabilities as of June 30, 2018 and December 31, 2017 are as follows (in thousands):

	June 30, 2018	December 31, 2017

	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Senior notes:				
6.625% Notes, net (1)	$ 393,727	$ 411,480	$ 392,909	$ 420,480
6.00% Notes, net (1)	79,359	95,520	79,199	90,240
Contingent consideration (earn-out) (2)	1,124	1,124	—	—

(1) The carrying amount of the debt instruments are net of unamortized debt issuance costs and certain debt discounts.

(2) During the three months ended June 30, 2018, we reduced the carrying amount of the Oakdale-Hampton Homes earn-out by $1.3 million to its estimated fair value.

In estimating the fair value of financial liabilities, we used the following methods and assumptions:

Senior Notes

As of June 30, 2018 and December 31, 2017, the fair values of the 6.625% Notes and the 6.00% Notes are estimated, based on quoted or estimated market prices. These fall within Level 2 of the fair value hierarchy.

Contingent Consideration (“earn-out”)

This was recognized as part of the purchase price paid for the Oakdale-Hampton Homes acquisition in 2018. At inception, the fair value was determined through the use of valuation models that simulated earnings, applying the terms of the earn-out in each simulated path, determining the average payment in each year across all the trials of the simulation, and calculating the present values of the future payments. The primary inputs and key assumptions include estimated future earnings, probabilities of achievement, earnings volatility, and the discount rate. These fall within Level 3 of the fair value hierarchy.

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ITEM 2. MANAGEMENT’S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Executive Overview

We are engaged in the business of homebuilding and community development in Florida, the Carolinas, Arizona and Texas. We also engage to a limited degree in other real estate activities, such as the operation of amenities and the sale of land for third-party development. We manage our business through four reportable segments: Florida, the Carolinas, Arizona and Texas.

For the six months ended June 30, 2018, we derived 40% of our revenues from Florida, 37% of our revenues from the Carolinas, 18% of our revenues from Arizona and 5% of our revenues from Texas.

Our primary business is the development of land and the construction and sale of homes. Our current homebuilding sales activities include locations in Florida, the Carolinas, Arizona and Texas, with additional communities in the pipeline for each region. We build both active adult communities, which are restricted to homeowners that are age 55 and older, and primary residential communities, which are open to all ages. This geographic and product segment diversification helps mitigate our overall business risks. We also opportunistically sell existing non-core commercial and industrial land positions, as well as scattered lot positions and land assets, that are in excess of our needed supply in a given market.

As of June 30, 2018, our selling community count included 71 locations: 21 in Florida, 31 in the Carolinas, seven in Arizona and 12 in Texas, with additional communities in the pipeline for each region. Our count of communities with closings as of June 30, 2018 included 63 locations: 17 in Florida, 31 in the Carolinas, six in Arizona and nine in Texas.

Solivita and Vitalia in Central Florida; CantaMia and Encore in Arizona; and Creekside at Bethpage in Raleigh, North Carolina currently serve as our flagship communities in the active adult market. These communities broaden our geographic footprint and product offering, and should provide us with market participation in the long-term growth of demand from the wave of Baby Boomers entering their retirement years.

We continue to invest in new and existing markets to create a more diversified portfolio that mitigates cyclical impact over time. Through homebuilder acquisitions and purchases of new land and lot positions, we have expanded and continue to expand within our existing markets in Central Florida, Charlotte, Raleigh, Jacksonville, the greater Phoenix area, and the Dallas-Fort Worth area. Replacement lot positions require new acquisitions of developed lots or platted or unplatted undeveloped land, or we may decide to develop current land holdings, depending on market conditions within the submarket of these assets.

Definitive Merger Agreement with Taylor Morrison Home Corporation

On June 7, 2018, we entered into an Agreement and Plan of Merger (the “Merger Agreement”) with Taylor Morrison Home Corporation, a Delaware corporation (“Taylor Morrison”), Taylor Morrison Communities, Inc., a Delaware corporation and an indirect subsidiary of Taylor Morrison (the “Intermediate Parent”), and Thor Merger Sub, Inc., a Delaware corporation and an indirect subsidiary of Taylor Morrison (the “Merger Sub”), pursuant to which Merger Sub will be merged with and into the Company (the “Merger”), with AV Homes continuing as the surviving entity in the Merger as an indirect subsidiary of Taylor Morrison. As a result of the merger, we will cease to be a publicly traded company.

Subject to the terms and conditions set forth in the Merger Agreement, at the effective time of the Merger (the “Effective Time”), each issued and outstanding share of common stock, par value $1.00 per share, of AV Homes (the “Company Common Shares”) (excluding any shares (i) subject to vesting, repurchase or other lapse restriction granted under a Company equity plan that is outstanding immediately prior to the Effective Time; (ii) held by any stockholder who properly demands and perfects his, her or its appraisal rights with respect to such shares; or (iii) owned directly by the Company (or any wholly owned subsidiary of the Company, Taylor Morrison or Merger Sub immediately prior to the Effective Time)) will be converted into the right to receive and become exchangeable for (A) 0.9793 validly issued, fully paid and nonassessable shares of Class A common stock, $0.00001 par value per share, of Taylor Morrison (the “Taylor Morrison Shares”), pursuant to applicable election procedures (subject to the pro ration as described below, the “Stock Election Consideration”); (B) $21.50 in cash, without any interest thereon, pursuant to applicable election procedures (subject to the pro ration as described below, the “Cash Election Consideration”); or (C) $12.64 in cash, without any interest thereon, and 0.4034 validly issued, fully paid and nonassessable Taylor Morrison Shares (the “Mixed Election Consideration” and, together with the Cash Election Consideration and the Stock Election Consideration, the “Merger Consideration”). The per share Cash Election Consideration and Stock Election Consideration are subject to adjustment pursuant to the terms of the Merger Agreement such that the aggregate Merger Consideration will consist of approximately 58.8% cash and approximately 41.2% Taylor Morrison Shares. No fractional Taylor Morrison Shares will be issued in the Merger, and the

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Company stockholders will receive cash in lieu of any fractional shares. See Note 1, Summary of Significant Accounting Policies, to our unaudited consolidated financial statements in Item 1 of this Form 10-Q for further discussion.

Key Operating Metrics

Our business is significantly influenced by a number of factors that affect our revenues and costs, including market demand for new homes, labor supply and wages, materials prices and availability, land availability, and mortgage rates and availability. In managing our business and the influence of these factors, we track several key operating metrics described below.

Contracts signed. Net contracts signed for a given period represents the number of contracts we have entered into with home buyers for the purchase and sale of homes, less the number of contracts that were cancelled in the same period. We consider a home sales contract cancelled when the customer terminates the contract or when we provide notice of termination due to a failure on the part of the customer to close on the home or meet a contingency under the contract.

Home starts. Home starts is the number of new homes on which we have started construction in a given period. Home starts are monitored by management in order to minimize the time between contract signing and home closing.

Closings. Closings represents the number of home sales closed in the period. We recognize revenue equal to the sales price of a home when the sales are closed and title passes to the purchasers.

Backlog. Backlog is the number of homes we are building that are under contract for sale that have not closed as of the end of the period being presented. The dollar value of backlog is the revenue anticipated to be realized at closing equal to the purchase price provided in the applicable contract. Backlog is an important indicator of home closings and homebuilding revenues in future periods.

Average sales price. Average sales price represents total revenue for a given period divided by the number of closings for such period.

Seasonality

Our business is affected to some extent by the seasonality of home sales, which generally produce increased closings in the latter half of the year. However, periods of economic downturn in the industry can alter seasonal patterns.

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Results of Operations

The following table provides a comparison of certain financial data related to our operations for the three and six months ended June 30, 2018 and 2017 (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
Operating income:				
Florida				
Revenues:				
Homebuilding	$ 74,140	$ 79,112	$ 132,243	$ 149,599
Amenity and other	4,289	4,125	9,107	8,762
Land sales	615	—	2,660	1,469
Total revenues	79,044	83,237	144,010	159,830
Expenses:				
Homebuilding cost of revenue	58,540	62,640	103,617	118,634
Homebuilding selling, general and administrative	9,313	9,106	18,415	18,404
Amenity and other	4,088	3,548	9,310	7,855
Land sales	207	—	438	196
Segment operating income	$ 6,896	$ 7,943	$ 12,230	$ 14,741
Carolinas				
Revenues:				
Homebuilding	$ 76,119	$ 82,517	$ 130,023	$ 129,362
Land sales	—	—	—	782
Total revenues	76,119	82,517	130,023	130,144
Expenses:				
Homebuilding cost of revenue	65,470	70,048	113,633	110,181
Homebuilding selling, general and administrative	8,173	9,140	15,130	14,163
Land sales	—	—	—	786
Segment operating income	$ 2,476	$ 3,329	$ 1,260	$ 5,014
Arizona				
Revenues:				
Homebuilding	$ 39,736	$ 35,255	$ 64,982	$ 66,583
Land sales	—	185	—	185
Total revenue	39,736	35,440	64,982	66,768
Expenses:				
Homebuilding cost of revenue	32,698	29,912	53,832	56,650
Homebuilding selling, general and administrative	4,269	3,782	7,394	7,153
Amenity and other	18	18	40	41
Land sales	—	180	—	180
Segment operating income	$ 2,751	$ 1,548	$ 3,716	$ 2,744

Texas				
Revenues:				
Homebuilding	$ 8,661	$ —	$ 16,553	$ —
Total revenue	8,661	—	16,553	—
Expenses:				
Homebuilding cost of revenue	7,347	—	13,950	—
Homebuilding selling, general and administrative	1,954	—	3,541	—
Segment operating loss	$ (640)	$ —	$ (938)	$ —
Operating income	$ 11,483	$ 12,820	$ 16,268	$ 22,499
Unallocated income (expenses):				
Interest income and other	581	253	850	258
Corporate general and administrative expenses	(5,009)	(4,986)	(9,753)	(9,665)
Loss on extinguishment of debt	—	(2,933)	—	(2,933)
Interest expense	(3,012)	(3,685)	(6,403)	(4,522)
Income before income taxes	4,043	1,469	962	5,637
Income tax expense	1,044	822	306	2,551
Net income	$ 2,999	$ 647	$ 656	$ 3,086

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Data from closings for the Florida, Carolinas, Arizona and Texas segments for the three and six months ended June 30, 2018 and 2017 is summarized as follows (dollars in thousands):

For the three months ended June 30,	Number of Units	Revenues	Average Price Per Unit
2018			
Florida	248	$ 74,140	$ 299
Carolinas	200	76,119	381
Arizona	117	39,736	340
Texas	27	8,661	321
Total	592	$ 198,656	336
2017			
Florida	268	$ 79,112	$ 295
Carolinas	220	82,517	375
Arizona	107	35,255	329
Texas	—	—	—
Total	595	$ 196,884	331

For the six months ended June 30,	Number of Units	Revenues	Average Price Per Unit
2018			
Florida	445	$ 132,243	$ 297
Carolinas	345	130,023	377
Arizona	187	64,982	347
Texas	53	16,553	312
Total	1,030	$ 343,801	334
2017			
Florida	515	$ 149,599	$ 290
Carolinas	342	129,362	378
Arizona	200	66,583	333
Texas	—	—	—
Total	1,057	$ 345,544	327

Three Months Ended June 30, 2018 and 2017

Total revenue increased by $2.4 million or 1.2% to $203.6 million during the three months ended June 30, 2018 compared to the three months ended June 30, 2017. Homebuilding revenue, which is revenue from home closings, increased $1.8 million to $198.7 million for the three months ended June 30, 2018 compared to the same period in 2017, primarily due to the increased average selling price of homes closed in all of our segments. In the Florida segment, homebuilding revenue decreased $5.0 million or 6.3% for the three months ended June 30, 2018 compared to the same period in 2017 due to a decrease in the number of communities in which we had closings from 22 to 17, partially offset by a 1.4% increase in the average selling price of homes closed. In the Carolinas segment, homebuilding revenue decreased by $6.4 million or 7.8% for the three months ended June 30, 2018 compared to the same period in 2017 due to a decrease in the number of communities in which we had closings from 35 to 31, partially offset by a 1.6% increase in the average selling price of homes closed. In the Arizona segment, homebuilding revenue increased $4.5 million or 12.7% for the three months ended June 30, 2018 compared to the same period in 2017 due to improved demand, the launch of new primary residential communities and a 3.3% increase in the average selling price of homes closed. In the Texas segment, the Oakdale-Hampton Homes acquisition, which marked our entry into the Dallas-Fort Worth market, improved our homebuilding revenue by $8.7 million during the three months ended June 30, 2018.

Gross margin, which is homebuilding revenue less homebuilding cost of revenue, remained unchanged at 17.4% for the three months ended June 30, 2018 compared to the same period in 2017. Gross margin from the Florida segment increased by 20 basis points to 21.0% from 20.8% for the three months ended June 30, 2018 compared to the same period in 2017. Gross margin from the Carolinas segment decreased by 110 basis points to 14.0% from 15.1% for the three months ended June 30, 2018 compared to the same period in 2017, primarily due to the closings in lower margin Savvy Homes communities. Gross margin from the Arizona segment improved 250 basis points to 17.7% from 15.2% for the three months ended June 30, 2018 compared to the same period in 2017 due to selective price increases, especially in our active adult communities. Gross margin from the Texas segment was 15.2% for the three months ended June 30, 2018 and included 280 basis points negative impact of the purchase accounting write-up of inventory in the Oakdale-Hampton Homes acquisition. Capitalized interest included in cost of sales for the Florida, Carolinas, Arizona and Texas segments was $1.6 million, $2.0 million, $1.4 million and less than $0.1 million, respectively, for the three months ended June 30, 2018 and was $2.0 million, $2.1 million and $1.3 million for the Florida, Carolinas and Arizona segments, respectively, for the same period in 2017.

Total selling, general and administrative expenses as a percentage of homebuilding revenue increased to 14.5% for the three months ended June 30, 2018 from 13.7% for the same period in 2017. Homebuilding selling, general and administrative expenses as a percentage of homebuilding revenue (“Homebuilding SG&A to Revenue Ratio”) increased to 11.9% for the three months ended June 30, 2018 from 11.2% for the same period in 2017. The Homebuilding SG&A to Revenue Ratio for the Florida segment increased to 12.6% for the three months ended June 30, 2018 compared to 11.5% for the same period in 2017, primarily due to fewer communities with closings resulting in lower revenue over a fixed cost base. The Homebuilding SG&A to Revenue Ratio for the Carolinas segment decreased to 10.7% for the three months ended June 30, 2018 compared to 11.1% for the three months ended June 30, 2017, primarily due to non-recurring adjustments related to the forfeiture of unvested share-based awards. The Homebuilding SG&A to Revenue Ratio for the Arizona segment remained unchanged for the three months ended June 30, 2018 at 10.7% compared to the same period in 2017. The Homebuilding SG&A to Revenue Ratio for the Texas segment was 22.6% for the three months ended June 30, 2018.

Corporate general and administrative expenses remained unchanged at $5.0 million or 2.5% of homebuilding revenue for the three months ended June 30, 2018 compared to the same period in 2017. During the three months ended June 30, 2018, we incurred approximately $1.4 million in acquisition-related costs associated with the proposed merger with Taylor Morrison, which were partially offset by a $1.3 million reduction of the 2018 Oakdale-Hampton Homes earn-out liability.

Interest expense decreased by $0.7 million to $3.0 million for the three months ended June 30, 2018 compared to the same period in 2017. There was $1.8 million of negative carry related to the incremental interest on the 8.50% Senior Notes due 2019 (the “8.50% Notes”) for a portion of the second quarter in 2017 in which they remained outstanding while we also had the 6.625% Notes issued and outstanding.

Income before income taxes for the three months ended June 30, 2018 was $4.0 million compared to $1.5 million for the three months ended June 30, 2017. The increase was primarily due to (i) the non-recurring $2.9 million loss on extinguishment of debt associated with the repurchase of our 8.50% Notes and the replacement of our senior secured credit facility in the second quarter of 2017, partially offset by (ii) the $1.7 million increase in selling, general and administrative expenses compared to the same period in 2017, mainly due to additional fixed overhead costs in 2018 related to the Oakdale-Hampton Homes acquisition.

Income tax expense for the three months ended June 30, 2018 was $1.0 million compared to $0.8 million for the three months ended June 30, 2017.

Net income for the three months ended June 30, 2018 was $3.0 million or $0.13 per diluted share compared to $0.6 million or $0.03 per diluted share for the three months ended June 30, 2017.

Six months Ended June 30, 2018 and 2017

Total revenue decreased by $1.2 million or 0.3% to $355.6 million during the six months ended June 30, 2018 compared to the six months ended June 30, 2017. Homebuilding revenue, which is revenue from home closings, decreased $1.7 million or 0.5% to $343.8 million for the six months ended June 30, 2018 compared to the same period in 2017, primarily due to declines in volume in Florida and Arizona, partially offset by a volume increase in Texas attributable to the Oakdale-Hampton Homes acquisition. In the Florida segment, homebuilding revenue decreased $17.4 million or 11.6% for the six months ended June 30, 2018 compared to the same period in 2017 due to a decrease in the number of communities in which we had closings from 22 to 17, partially offset by a 2.4% increase in the average selling price of homes closed. In the Carolinas segment, homebuilding revenue increased by $0.7 million or 0.5% for the six months ended June 30, 2018 compared to the same period in 2017 due to a

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slight increase in volume, partially offset by a 0.3% decrease in average selling price of homes closed. In the Arizona segment, homebuilding revenue decreased $1.6 million or 2.4% for the six months ended June 30, 2018 compared to the same period in 2017 due to a decrease in the number of communities in which we had closings from nine to six, partially offset by a 4.2% increase in the average selling price of homes closed. In the Texas segment, the Oakdale-Hampton Homes acquisition, which marked our entry into the Dallas-Fort Worth market, improved our homebuilding revenue by $16.6 million during the six months ended June 30, 2018.

Gross margin, which is homebuilding revenue less homebuilding cost of revenue, decreased by 30 basis points to 17.1% from 17.4% for the six months ended June 30, 2018 compared to the same period in 2017. Gross margin from the Florida segment improved by 90 basis points to 21.6% from 20.7% for the six months ended June 30, 2018 compared to the same period in 2017, primarily due to the mix of communities with closings and selective price increases. Gross margin from the Carolinas segment decreased by 220 basis points to 12.6% from 14.8% for the six months ended June 30, 2018 compared to the same period in 2017, primarily due to the closings in lower margin Savvy Homes communities. Gross margin from the Arizona segment improved 230 basis points to 17.2% from 14.9% for the six months ended June 30, 2018 compared to the same period in 2017 due to selective price increases, especially in our active adult communities. Gross margin from the Texas segment was 15.7% for the six months ended June 30, 2018 and included 330 basis points negative impact of the purchase accounting write-up of inventory in the Oakdale-Hampton Homes acquisition. Capitalized interest included in cost of sales for the Florida, Carolinas, Arizona and Texas segments was $2.9 million, $3.5 million, $2.3 million and $0.1 million, respectively, for the six months ended June 30, 2018 and was $3.8 million, $3.5 million and $2.6 million for the Florida, Carolinas and Arizona segments, respectively, for the same period in 2017.

Total selling, general and administrative expenses as a percentage of homebuilding revenue increased to 15.8% for the six months ended June 30, 2018 from 14.3% for the same period in 2017. The Homebuilding SG&A to Revenue Ratio increased to 12.9% for the six months ended June 30, 2018 from 11.5% for the same period in 2017. The Homebuilding SG&A to Revenue Ratio for the Florida segment increased to 13.9% for the six months ended June 30, 2018 compared to 12.3% for the same period in 2017, primarily due to fewer communities with closings resulting in lower revenue over a fixed cost base. The Homebuilding SG&A to Revenue Ratio for the Carolinas segment increased to 11.6% for the six months ended June 30, 2018 compared to 10.9% for the six months ended June 30, 2017, mainly due to lower revenue over a fixed cost base and increased costs associated with a higher level of speculative inventory sales. The Homebuilding SG&A to Revenue Ratio for the Arizona segment increased to 11.4% for the six months ended June 30, 2018 from 10.7% for the six months ended June 30, 2017, primarily due to fewer communities with closings resulting in lower revenue over a fixed cost base. The Homebuilding SG&A to Revenue Ratio for the Texas segment was 21.4% for the six months ended June 30, 2018.

Corporate general and administrative expenses increased $0.1 million to $9.8 million for the six months ended June 30, 2018 compared to the same period in 2017. As a percentage of homebuilding revenue, corporate general and administrative expenses remained unchanged at 2.8% for the six months ended June 30, 2018 compared to the same period in 2017. During the six months ended June 30, 2018, we incurred approximately $1.4 million in acquisition-related costs associated with the proposed merger with Taylor Morrison, which was partially offset by a $1.3 million reduction of the 2018 Oakdale-Hampton Homes earn-out liability.

Interest expense increased by $1.9 million to $6.4 million for the six months ended June 30, 2018 compared to the same period in 2017. The increase in interest expense is a result of higher average outstanding debt in 2018 compared to the prior year associated with the issuance of our 6.625% Notes in May 2017 and the repurchase of $45.5 million of our 8.50% Notes, partially offset by a 120 basis point reduction in our weighted average interest rate.

Income before income taxes for the six months ended June 30, 2018 was $1.0 million compared to $5.6 million for the six months ended June 30, 2017. The decrease was primarily due to (i) the $6.4 million of interest expense during the six months ended June 30, 2018 compared to $4.5 million for the same period in 2017 due to the issuance of the 6.625% Notes in May 2017, (ii) the $4.8 million increase in selling, general and administrative expenses compared to the same period in 2017, mainly due to additional fixed overhead costs in 2018 related to the Savvy Homes and Oakdale-Hampton Homes acquisitions, and (iii) a $0.9 million non-recurring increase in amenity and other expenses compared to the same period in 2017, partially offset by (iv) the non-recurring $2.9 million loss on extinguishment of debt associated with the repurchase of our 8.50% Notes and the replacement of our senior secured credit facility in the second quarter of 2017.

Income tax expense for the six months ended June 30, 2018 was $0.3 million compared to $2.6 million for the six months ended June 30, 2017.

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Net income for the six months ended June 30, 2018 was $0.7 million or $0.03 per diluted share compared to $3.1 million or $0.14 per diluted share for the six months ended June 30, 2017.

Data from contracts signed for the Florida, Carolinas, Arizona and Texas segments for the three and six months ended June 30, 2018 and 2017 is summarized as follows (dollars in thousands):

For the three months ended June 30,	Gross Number of Contracts Signed	Cancellations	Contracts Signed, Net of Cancellations	Dollar Value	Average Price Per Unit
2018					
Florida	259	(28)	231	$ 70,843	$ 307
Carolinas	215	(15)	200	76,082	380
Arizona	177	(28)	149	50,306	338
Texas	65	(25)	40	14,573	364
Total	716	(96)	620	$ 211,804	342
2017					
Florida	405	(36)	369	$ 108,789	$ 295
Carolinas	236	(29)	207	76,768	371
Arizona	141	(26)	115	38,141	332
Texas	—	—	—	—	—
Total	782	(91)	691	$ 223,698	324

For the six months ended June 30,	Gross Number of Contracts Signed	Cancellations	Contracts Signed, Net of Cancellations	Dollar Value	Average Price Per Unit
2018					
Florida	614	(59)	555	$ 163,561	$ 295
Carolinas	481	(49)	432	165,933	384
Arizona	346	(50)	296	98,018	331
Texas	124	(56)	68	26,320	387
Total	1,565	(214)	1,351	$ 453,832	336
2017					
Florida	807	(75)	732	$ 213,835	$ 292
Carolinas	441	(49)	392	147,083	375
Arizona	282	(51)	231	77,566	336
Texas	—	—	—	—	—

Total	1,530	(175)	1,355	$ 438,484	324

Three Months Ended June 30, 2018 and 2017

The total number of net housing contracts signed during the three months ended June 30, 2018 compared to the same period in 2017 decreased by 71 units or 10.3%. The dollar value of housing contracts signed decreased by $11.9 million or 5.3% over the same period. The decrease in units was driven by Florida and the Carolinas, partially offset by increases in the Arizona and Texas segments. The number of net housing contracts signed for the Florida segment during the three months ended June 30, 2018 decreased by 138 units or 37.4%, while the dollar value of housing contracts signed decreased by $37.9 million or 34.9%, due to the decrease in selling communities from 25 to 21. The number of net housing contracts signed for the Carolinas segment during the three months ended June 30, 2018 decreased by seven units or 3.4%, due to the decrease in selling communities from 38 to 31, while the dollar value of housing contracts signed decreased by $0.7 million or 0.9%. The number of net housing contracts signed for the Arizona segment during the three months ended June 30, 2018 increased by 34 units or 29.6%, while the dollar value of housing contracts signed increased by $12.2 million or 31.9%, driven mainly by improved demand and the launch of new primary residential communities in 2018. The number of net housing contracts signed for the Texas segment during the three months ended June 30, 2018 was 40 units or $14.6 million, due to the Oakdale-Hampton Homes acquisition in January 2018.

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The cancellation rate during the three months ended June 30, 2018 increased to 13.4% from 11.6% compared to the same period in 2017. The cancellation rate in the Florida segment increased to 10.8% from 8.9% over the same period due to higher-than-normal lot transfers in a new community launched in early 2018. The cancellation rate in the Carolinas segment during the three months ended June 30, 2018 improved to 7.0% from 12.3% during the three months ended June 30, 2017, attributable to a higher proportion of speculative inventory sales during the period, which tend to have lower cancellation rates. The cancellation rate in the Arizona segment during the three months ended June 30, 2018 improved to 15.8% from 18.4% compared to the same period in 2017, primarily due to a reduction in contingency-related sales compared to a year ago. The cancellation rate in the Texas segment during the three months ended June 30, 2018 was 38.5%, due to a high number of foreign buyers and first-time home buyers who tend to have higher cancellation rates.

Six Months Ended June 30, 2018 and 2017

The total number of net housing contracts signed during the six months ended June 30, 2018 compared to the same period in 2017 decreased by 4 units or 0.3%. The dollar value of housing contracts signed increased by $15.3 million or 3.5% over the same period. The Carolinas, Arizona and Texas segments each had increases in net housing contracts signed, more than offset by a decrease in the Florida segment. The number of net housing contracts signed for the Florida segment during the six months ended June 30, 2018 decreased by 177 units or 24.2%, while the dollar value of housing contracts signed decreased by $50.3 million or 23.5%, due to the decrease in selling communities from 25 to 21. The number of net housing contracts signed for the Carolinas segment during the six months ended June 30, 2018 increased by 40 units or 10.2%, primarily as a result of the launch of newer communities, while the dollar value of housing contracts signed increased by $18.9 million or 12.8%. The number of net housing contracts signed for the Arizona segment during the six months ended June 30, 2018 increased by 65 units or 28.1%, while the dollar value of housing contracts signed increased by $20.5 million or 26.4%, driven mainly by the launch of new communities and more attractive pricing options in certain primary residential communities in 2018. The number of net housing contracts signed for the Texas segment during the six months ended June 30, 2018 was 68 units or $26.3 million, due to the Oakdale-Hampton Homes acquisition in January 2018.

The cancellation rate during the six months ended June 30, 2018 increased to 13.7% from 11.4% compared to the same period in 2017. The cancellation rate in the Florida segment increased slightly to 9.6% from 9.3% over the same period. The cancellation rate in the Carolinas segment during six months ended June 30, 2018 decreased to 10.2% from 11.1% during the six months ended June 30, 2017, attributable to a higher proportion of speculative inventory sales during the period, which tend to have lower cancellation rates. The cancellation rate in the Arizona segment during the six months ended June 30, 2018 improved to 14.5% from 18.1% compared to the same period in 2017, primarily due to a reduction in contingency-related sales compared to a year ago. The cancellation rate in the Texas segment during the six months ended June 30, 2018 was 45.2%, due to a high number of foreign buyers and first-time home buyers who tend to have higher cancellation rates.

Backlog for the Florida, Carolinas, Arizona and Texas segments as of June 30, 2018 and 2017 is summarized as follows (dollars in thousands):

As of June 30,	Number of Units	Dollar Volume	Average Price Per Unit
2018			
Florida	482	$ 143,788	$ 298
Carolinas	289	110,769	383
Arizona	259	85,308	329
Texas	62	25,406	410
Total	1,092	$ 365,271	334
2017			
Florida	559	$ 165,721	$ 296
Carolinas	311	119,262	383
Arizona	200	68,381	342
Texas	—	—	—
Total	1,070	$ 353,364	330

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The backlog of housing contracts as of June 30, 2018 compared to June 30, 2017 increased by 22 units or 2.1%, and the dollar value of backlog increased by $11.9 million or 3.4% over the same period. The backlog of housing contracts in the Florida segment as of June 30, 2018 compared to June 30, 2017 decreased by 77 units or 13.8%, and the dollar value decreased by $21.9 million or 13.2% over the same period, driven by the decrease in selling communities from 25 to 21. The backlog of housing contracts in the Carolinas segment as of June 30, 2018 compared to June 30, 2017 decreased by 22 units or 7.1%, and the dollar value decreased by $8.5 million or 7.1% over the same period, primarily as a result of the decrease in selling communities from 38 to 31. The backlog of housing contracts in the Arizona segment as of June 30, 2018 compared to June 30, 2017 increased by 59 units or 29.5%, and the dollar value increased by $16.9 million or 24.8% over the same period, driven by improved demand in newer communities, which is more than offsetting decreases in communities that closed out in 2017. The backlog of housing contracts in the Texas segment as of June 30, 2018 was 62 units or $25.4 million due to the Oakdale-Hampton Homes acquisition in January 2018.

As of June 30, 2018, our inventory of unsold (speculative) homes, both completed and under construction, was 688 units, as compared to 545 units as of June 30, 2017. As of June 30, 2018, approximately 28% of unsold homes were completed compared to approximately 25% as of June 30, 2017. The increase in speculative homes is mainly due to the Oakdale-Hampton Homes acquisition.

The following is a breakdown of our owned or controlled land holdings as of June 30, 2018 and December 31, 2017:

	June 30, 2018				December 31, 2017			
	Developed Lots	Partially Developed Lots	Raw Lots	Total Remaining Lots (1)	Developed Lots	Partially Developed Lots	Raw Lots	Total Remaining Lots (1)
Florida								
Active adult	676	332	6,179	7,187	794	332	6,179	7,305
Primary residential	1,694	481	2,276	4,451	1,269	912	1,336	3,517
	2,370	813	8,455	11,638	2,063	1,244	7,515	10,822
Carolinas								
Active adult	171	155	165	491	219	—	234	453
Primary residential	1,619	414	380	2,413	1,750	520	30	2,300
	1,790	569	545	2,904	1,969	520	264	2,753
Arizona								
Active adult	493	561	452	1,506	584	561	452	1,597
Primary residential	301	272	458	1,031	295	70	545	910
	794	833	910	2,537	879	631	997	2,507
Texas								
Active adult	—	—	—	—	—	—	—	—
	797	491	—	1,288	—	—	—	—

Primary residential	797	491	—	1,288	—	—	—	—
Total principal communities	5,751	2,706	9,910	18,367	4,911	2,395	8,776	16,082

(1) Estimated lots are based on historical densities for our land. New projects may ultimately be developed into more or less than the number of lots stated.

In addition to the lots presented in the table above, we also have approximately 1,700 acres of commercial and industrial land and approximately 5,000 acres of unplatted scattered mixed-use land, primarily in Florida. We also have approximately 700 platted scattered lots, primarily in Arizona.

Income Taxes

Our effective tax rate for the three and six months ended June 30, 2018 was 25.8% and 31.8%, respectively. Our effective tax rate for the three and six months ended June 30, 2017 was 55.9% and 45.3%, respectively. Our effective tax rate is impacted by a number of factors, the most significant of which is the enactment of the TCJA on December 22, 2017. For the year ended December 31, 2017, our deferred tax assets were remeasured based on the corporate income tax rate change from 35% to 21%. Effective January 1, 2018, the lower federal rate of 21% and other changes to tax laws affect the value of our deferred tax assets and the effective tax rate going forward.

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Certain states enacted changes to tax rates that impacted the value of our deferred tax assets in 2017. The estimated impact of such changes was recorded to income tax expense during the period of change.

Liquidity and Capital Resources

Our primary business activities are capital intensive in nature. Significant capital resources are required to finance planned residential communities, homebuilding construction in process, community infrastructure, selling expenses, new projects and working capital needs, including funding of debt service requirements, operating deficits and the carrying costs of land. We finance these activities using cash provided by operating activities, capital market financing and our Senior Unsecured Credit Facility. For more information regarding our debt, see Note 4, Senior Debt, to our unaudited consolidated financial statements in Item 1 of this Form 10-Q.

Cash Flows

As of June 30, 2018, our cash, cash equivalents and restricted cash totaled $117.8 million compared to $242.2 million as of December 31, 2017. As of June 30, 2018, total consolidated indebtedness was $480.0 million. The decrease in cash and cash equivalents as of June 30, 2018 is primarily due to the acquisition of Oakdale-Hampton Homes and the increase in homes completed or under construction.

Our operating cash flows fluctuate relative to the status of development within existing communities, expenditures for land, new developments and other real estate activities, sales of various homebuilding product lines within those communities and other developments and to fund operating deficits.

For the six months ended June 30, 2018, net cash used in operating activities was $78.2 million. The operating cash outflow was primarily due to the $101.0 million increase in land and other inventories as we further developed and completed our land and lots for delivery. These outflows were partially offset by (i) the $9.3 million decrease in receivables, mainly due to the decrease in amounts due from title companies for home closings; and (ii) the $6.8 million increase in accounts payable and accrued liabilities, primarily as a result of the change in the timing of our interest payments as we replaced the 8.50% Notes with the 6.625% Notes. Net cash used in investing activities was $46.1 million mainly due to the acquisition of Oakdale-Hampton Homes. Net cash used in financing activities was $0.1 million.

For the six months ended June 30, 2017, net cash used in operating activities was $36.0 million. The operating cash outflow was primarily due to the $46.5 million increase in land and other inventories as we further developed and completed our land and lots for delivery commensurate with the increase in our home closings, the $4.0 million increase in prepaid expenses and other assets, and the $6.6 million increase in accounts payable and accrued and other liabilities. These outflows were partially offset by our net income, a $2.9 million loss on extinguishment of debt related to the repurchase of a portion of our 8.50% Notes, a $1.3 million decrease in receivables, a $5.7 million increase in our customer deposits driven by a 52% increase in backlog since December 31, 2016, and a $2.4 million decrease in our net deferred tax assets. Net cash used in investing activities was $42.3 million mainly due to the acquisition of Savvy Homes. Net cash provided by financing activities was $341.9 million, primarily due to proceeds from the issuance of the 6.625% Notes, partially offset by the repurchase of the 8.50% Notes and $8.1 million in debt issuance costs.

Other

Assuming that no significant adverse changes occur in our business, we anticipate the aggregate cash on hand, cash flow generated through homebuilding and related operations, and the Senior Unsecured Credit Facility will provide sufficient liquidity to fund our business for the next twelve months.

Off Balance Sheet Arrangements

Surety bonds, issued by third-party entities, are used primarily to guarantee our performance to construct improvements in our various communities. As of June 30, 2018, we had outstanding surety bonds of approximately $50 million. The amount of outstanding surety bonds could fluctuate depending on the level of development activity. We do not believe that it is likely any of these outstanding surety bonds will be drawn upon.

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Critical Accounting Policies

There were no material changes in AV Homes' critical accounting policies during the six months ended June 30, 2018. However, we updated our revenue recognition policy to reflect the adoption of ASC 606, which we deemed not material to our consolidated financial statements upon adoption. For additional information regarding AV Homes' critical accounting policies, refer to Item 7, Management's Discussion and Analysis, in our Annual Report on Form 10-K for the year ended December 31, 2017.

Special Notes Concerning Forward-Looking Statements

Certain statements discussed in Item 2, Management's Discussion and Analysis of Financial Condition and Results of Operations, and elsewhere in this Form 10-Q constitute "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995. Such forward-looking statements involve known and unknown risks, uncertainties and other important factors that could cause the actual results, performance or achievements of results to differ materially from any future results, performance or achievements expressed or implied by such forward-looking statements. Such risks, uncertainties and other important factors include, among others: the cyclical nature of the homebuilding industry and its dependence on broader economic conditions; availability and suitability of undeveloped land and improved lots; ability to develop communities within expected timeframes; increases in interest rates and availability of mortgage financing; elimination or reduction of tax benefits associated with home ownership; the prices and supply of building materials; the availability and skill of subcontractors; our ability to successfully integrate acquired businesses; effect of our expansion efforts on our cash flows and profitability; competition for home buyers, properties, financing, raw materials and skilled labor; our ability to access sufficient capital; our ability to generate sufficient cash to service our indebtedness; terms of our financing documents that may restrict our operations and corporate actions; fluctuations in interest rates; our current level of indebtedness and potential need for additional financing; our ability to purchase outstanding notes upon certain fundamental changes; our ability to obtain letters of credit and surety bonds; cancellations of home sale orders; the geographic concentration of our operations; inflation affecting homebuilding costs or deflation affecting declines in spending and borrowing levels; warranty and construction defect claims; health and safety incidents in homebuilding activities; the seasonal nature of our business; impacts of weather conditions and natural disasters; resource shortages and rate fluctuations; value and costs related to our land and lot inventory; overall market supply and demand for new homes; our ability to recover our costs in the event of reduced home sales; conflicts of interest involving our largest stockholder; contractual restrictions under a stockholders agreement with our largest stockholder; dependence on our senior management; effects of government regulation of development and homebuilding projects; development liabilities that may impose payment obligations on us; our ability to utilize our deferred income tax asset; impact of environmental changes and governmental actions in response to environmental changes; dependence on digital technologies and related cyber risks; future sales or dilution of our equity; impairment of intangible assets; and other factors described in our Annual Report on Form 10-K for the year ended December 31, 2017. In addition, material risks that could cause actual results to differ from forward-looking statements include: the inherent uncertainty associated with financial or other projections; the integration of Taylor Morrison and AV Homes and the ability to recognize the anticipated benefits from the combination of Taylor Morrison and AV Homes; the risk associated with AV Homes' ability to obtain the shareholder approval required to consummate the merger and the timing of the closing of the merger, including the risk that the conditions to the transaction are not satisfied on a timely basis or at all and the failure of the transaction to close for any other reason; the outcome of any legal proceedings that may be instituted against the parties and others related to the Merger Agreement; unanticipated difficulties or expenditures relating to the transaction, the response of business partners and retention as a result of the announcement and pendency of the transaction; risks relating to the value of the Taylor Morrison common stock to be issued in connection with the transaction; the anticipated size of the markets and continued demand for Taylor Morrison's and AV Homes' homes and the impact of competitive responses to the announcement of the transaction; and access to available financing on a timely basis and on reasonable terms, including the refinancing of Taylor Morrison and AV Homes debt to fund the cash portion of the consideration in connection with the transaction. Readers are cautioned not to place undue reliance on any forward-looking statements contained herein, which reflect management's opinions only as of the date hereof.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

There were no material changes in AV Homes' market risk during the six months ended June 30, 2018. For additional information regarding AV Homes' market risk, refer to Item 7A, Quantitative and Qualitative Disclosures About Market Risk, in our Annual Report on Form 10-K for the year ended December 31, 2017.

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ITEM 4. CONTROLS AND PROCEDURES

Disclosure Controls and Procedures

Our management, with the participation of the Chief Executive Officer and the Chief Financial Officer, has evaluated the effectiveness of our disclosure controls and procedures as of the end of the period covered by this report. Based on this evaluation, the Chief Executive Officer and the Chief Financial Officer have concluded that our disclosure controls and procedures were effective as of the end of the period covered by this report.

Internal Control Over Financial Reporting

Under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, we have determined that, during the fiscal quarter ended June 30, 2018, there were no changes in our internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II. Other Information

ITEM 1. LEGAL PROCEEDINGS

Information related to pending legal proceedings is presented in Note 6, Commitments and Contingencies, in the accompanying consolidated financial statements and is incorporated by reference herein.

ITEM 1A. RISK FACTORS

There have not been any material changes to the risk factors discussed in Part I, Item 1A of our Annual Report on Form 10-K for the year ended December 31, 2017, except for the additional risk factors set forth below:

There can be no assurance that our proposed merger with Taylor Morrison will be completed or that we will recognize the expected benefits from the merger.

Completion of the proposed merger with Taylor Morrison is subject to certain closing conditions, including approval by our stockholders, and there is no assurance that the transaction will be completed. If the merger is not completed in a timely basis, or at all, our business may be adversely affected by certain costs we have paid, and other costs, including a potential termination fee payment, we may need to pay, and it may be difficult to redirect our business to proceed as an independent company.

If the merger does proceed, stockholders may not receive all consideration in the form they elect based on the maximum amount of cash available as consideration in the merger. Stockholders who receive stock of Taylor Morrison will be subject to risks that apply to Taylor Morrison, which may negatively impact the price of Taylor Morrison's stock. Furthermore, because the exchange ratio is fixed and the market price of our stock and Taylor Morrison's stock will fluctuate, our stockholders receiving stock of Taylor Morrison cannot be sure of the market value of the stock they will receive as merger consideration.

Similarly, the combined company may not be able to realize the cost savings, synergies and other benefits of the merger due to integration difficulties and other challenges. While Taylor Morrison currently anticipates the merger will be accretive to earnings per share (on an adjusted earnings basis) during the first full calendar year after the merger, the expectation is based on preliminary estimates that may materially change. The future results of the combined company will suffer if it does not effectively manage its expanded operations following the merger.

Taylor Morrison and we have incurred substantial expenses related to the merger, and Taylor Morrison will incur additional expenses related to the integration, which will result in significant charges against earnings following the merger. It is also unclear how suppliers and strategic alliances of ours and Taylor Morrison will react to the merger, and it may result in the termination of some existing contracts that impair the combined company's business and financial results. The combined company will have a substantial amount of debt, which could adversely affect the combined company's business, financial condition or results of operations, and could prevent the combined company from fulfilling its debt-related obligations.

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Our financial condition, results of operations and cash flows could be adversely impacted as a result of the pending merger.

The uncertainty about the effect of the merger may have an adverse effect on our ability to attract, retain and motivate personnel. In addition, we are subject to business uncertainties and contractual restrictions while the merger is pending, which could adversely affect our business and operations. It is possible that some customers, suppliers or other persons with whom we have a business relationship may delay or defer certain business decisions or might seek to terminate, change or renegotiate their relationships with us as a result of the merger. Furthermore, the process of planning to integrate two businesses and organizations for the post-merger period can divert management attention and resources and have an adverse impact on our financial condition, results of operations and cash flows.

ITEM 6. EXHIBITS

2.1		Agreement and Plan of Merger, dated June 7, 2018, among Taylor Morrison Home Corporation, Taylor Morrison Communities, Inc., Thor Merger Sub, Inc. and AV Homes, Inc. (filed as Exhibit 2.1 to Form 8-K dated June 7, 2018 (File No. 1-7395), and incorporated herein by reference).
3.1	*	Certificate of Incorporation, as amended and restated May 28, 1998 (filed as Exhibit 3(a) to Form 10-Q for the quarter ended June 30, 1998 (File No. 1-7395), and incorporated herein by reference).
3.2	*	Certificate of Amendment of Restated Certificate of Incorporation, dated May 25, 2000 (filed as Exhibit 3(a) to Form 10-Q for the quarter ended June 30, 2000 (File No. 1-7395), and incorporated herein by reference).
3.3	*	Amended and Restated By-Laws, dated March 31, 2014 (filed as Exhibit 3.2 to Form 8-K dated March 31, 2014 (File No. 1-7395), and incorporated herein by reference).
4.1	*	Indenture, dated February 4, 2011, between Avatar Holdings Inc. and Wilmington Trust FSB, as Trustee (filed as Exhibit 4.1 to Form 8-K dated February 4, 2011 (File No. 1-7395), and incorporated herein by reference).
4.2	*	Third Supplemental Indenture, dated June 23, 2015, between AV Homes, Inc. and Wilmington Trust FSB, as Trustee, in respect of 6.00% Senior Convertible Notes due 2020 (filed as Exhibit 4.2 to Form 8-K dated June 23, 2015 (File No. 1-7395), and incorporated herein by reference).
4.3	*	Senior Notes Indentures, dated May 18, 2017, among AV Homes, Inc., the Subsidiary Guarantors named therein, and Wilmington Trust, National Association, as Trustee, relating to the 6.625% Senior Notes due 2022 (filed as Exhibit 4.1 to Form 8-K dated May 18, 2017 (File No. 1-7395), and incorporated herein by reference).
31.1		Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (filed herewith).
31.2		Certification of Principal Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (filed herewith).
32.1		Certification of Chief Executive Officer required by 18 U.S.C. Section 1350 (as adopted by Section 906 of the Sarbanes-Oxley Act of 2002) (furnished herewith).
32.2		Certification of Principal Financial Officer required by 18 U.S.C. Section 1350 (as adopted by Section 906 of the Sarbanes-Oxley Act of 2002) (furnished herewith).
99.1		

	Voting Agreement, dated June 7, 2018, by and between Taylor Morrison Home Corporation and TPG Capital (filed as Exhibit 99.1 to Form 8-K dated June 7, 2018 (File No. 1-7395), and incorporated herein by reference).
101.INS	XBRL Instance Document.
101.SCH	XBRL Taxonomy Extension Schema.
101.CAL	XBRL Taxonomy Extension Calculation Linkbase.
101.DEF	XBRL Taxonomy Extension Definition Linkbase.
101.LAB	XBRL Taxonomy Extension Label Linkbase.
101.PRE	XBRL Taxonomy Extension Presentation Linkbase.

*These exhibits are incorporated by reference and are on file with the Securities and Exchange Commission.

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

		AV HOMES, INC.
Date: August 1, 2018	By:	/s/ Roger A. Cregg Roger A. Cregg President and Chief Executive Officer (Principal Executive Officer)
Date: August 1, 2018	By:	/s/ Michael S. Burnett Michael S. Burnett Executive Vice President and Chief Financial Officer (Principal Financial and Accounting Officer)